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THE CREDIT DEREGULATION AND AVAILABILITY ACT OF 1983

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 730

TO AMEND THE DEPOSITORY INSTITUTIONS DEREGULATION AND
MONETARY CONTROL ACT OF 1980

APRIL 12, 1983

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THE CREDIT DEREGULATION AND AVAILABILITY ACT OF 1983

TUESDAY, APRIL 12, 1983

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Washington, D.C.

The committee met at 9 a.m., in room SD-538, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Gorton, Hawkins, Hecht, and Proxmire.

OPENING STATEMENT OF CHAIRMAN GARN

The **Chairman**. The Banking Committee will come to order.

We have a very full day of hearings scheduled today on S. 730, the Credit Deregulation and Availability Act of 1983. This important piece of legislation, which I introduced along with Senator Proxmire and its original sponsor from the 97th Congress, Senator Lugar, represents virtually the last step in deregulation of the price controls that have governed financial institutions and other creditors.

S. 730 completes the process begun 3 years ago with the enactment of the Depository Institutions Deregulation Act of 1980. That act permanently eliminated all interest rate ceilings applicable to first mortgage credit transactions and established a Federal alternative to State interest rate ceilings of 5 percent above the discount rate for business and agricultural credit. The business and agricultural interest rate alternate expired less than 2 weeks ago. However, it proved to be extremely helpful in maintaining credit availability during the high interest rate periods of the last few years.

The bill follows the mortgage credit precedent by permanently eliminating the interest rate ceilings which govern business, agricultural, and consumer credit. Also, in keeping with the 1980 act, the individual States are given 3 years to reject the Federal action.

The elimination of these remaining ceilings will bring to an end the distortions in the marketplace that occur as a result of the interplay of interest rate ceilings and constantly fluctuating market rates. Particularly during periods of rising interest rates, credit interest rate ceilings disrupt credit flows, reduce competition, and create credit allocations and subsidizations. Below market rate ceilings result in the subsidization of borrowers in low-rate States by borrowers in high-rate States and the subsidization of credit customers by cash customers.

It is even more critical now than ever before that the Congress take action on this legislation since late last year, we virtually eliminated the interest rate ceilings that for decades have applied to deposit accounts at financial institutions. Now that the marketplace is establishing the rate of interest that consumers can earn on their savings, the way has been paved for savers no longer being forced by law to subsidize borrowers. However, that subsidization will never be completely eliminated until the marketplace is allowed to also govern the rate charged borrowers.

I want to emphasize that there have been previous hearings on this issue, including a very extensive record on almost identical legislation which was developed during 3 days of hearings in the last Congress. Therefore, I have requested witnesses to limit their oral statements to 5 minutes in order to make room for a large number of witnesses and leave more time for questions.

Since we could not physically accommodate any more witnesses today—many of whom testified in 1981—I would like to recognize those groups that have already submitted statements for the record strongly supporting S. 730: the Independent Bankers Association of America; the National Automobile Dealers Association; the National Savings and Loan League; the National Association of Mutual Savings Banks; the National Association of Federal Credit Unions; Sears, Roebuck and Co.; VISA; National Commercial Finance Conference; National Home Furnishings Association; Recreation Vehicle Industry Association; National Association of Remodeling Industry; and General Motors Acceptance Corp.

I look forward to all of the testimony today.

And I welcome you, Beryl Sprinkel, Under Secretary for Monetary Affairs of the Department of the Treasury, as our leadoff witness.

Senator Proxmire.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator Proxmire. Thank you very much, Mr. Chairman.

Mr. Chairman, I'm delighted that we're moving on this legislation. There is nothing more shortsighted or counterproductive than providing ceilings on interest rates by law. It's kind of price control once removed. That doesn't work—in peacetime, at least. So, I favor the idea.

However, I am still very concerned about our moving in on the States.

Remember, we had, on this committee, Bob Morgan, who was a great champion of States' rights. I think he had a very good point.

It would seem to me if we can possibly find some way of providing at least some discretion of the States. If I were a State legislator in Wisconsin, I'd be vehemently opposed to the usury ceilings.

At the same time, I'm deeply troubled with the Federal Government, at a time when we all know we should be centralized as much as we can, reasonably and efficiently, moving ahead with this kind of usurpation.

I'll be interested in hearing the witnesses' comments.

The CHAIRMAN. I would agree completely with you, Senator. That's why, to the dismay of many, we put in the legislation the 3-year period of time when State legislatures could say, "We disagree with you." I don't know how we can give them a better opportunity than that.

You have a couple of legislative sessions, a period of 3 years, to say, "We don't like this."

Senator Gorton, do you have any statement you wish to make?

Senator GORTON. No, Mr. Chairman.

[Copy of bill being considered follows:]

II

98TH CONGRESS
1ST SESSION

S. 730

To amend the Depository Institutions Deregulation and Monetary Control Act of 1980.

IN THE SENATE OF THE UNITED STATES

MARCH 8 (legislative day, MARCH 7), 1983

Mr. GARN (for himself, Mr. PROXMIRE, and Mr. LUGAR) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Depository Institutions Deregulation and Monetary Control Act of 1980.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Credit Deregulation and Availability Act of 1983".

BUSINESS AND AGRICULTURAL CREDIT

SEC. 2. (a) Section 511 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public Law 96–221) is amended to read as follows:

“BUSINESS AND AGRICULTURAL LOANS

“SEC. 511. (a) The provisions of the constitution or the laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for interest, discount, points, a time price differential, finance charges or other fees or charges that may be charged, taken, received, or reserved shall not apply in the case of business or agricultural credit.

“(b) As used in this part, the term—

“(1) ‘agricultural credit’ means credit extended primarily for agricultural purposes to a person that cultivates, plants, propagates, or nurtures an agricultural product;

“(2) ‘agricultural purposes’ include the production, harvest, exhibition, marketing, transportation, processing, or manufacturing of an agricultural product and the acquisition of farmland, real property with a farm residence and personal property and services used primarily in farming;

“(3) ‘agricultural product’ includes agricultural, horticultural, viticultural, and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shellfish and any products thereof, including processed and manufactured products and any and all products raised or produced on farms and any processed or manufactured products thereof;

"(4) 'business credit' means credit extended primarily for business or commercial purposes, including investment, and any credit extended to a person other than a natural person; and

"(5) 'credit' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit.".

(b) Section 512 of the Depository Institutions Deregulation and Monetary Control Act of 1980 is amended to read as follows:

"APPLICABILITY

"SEC. 512. (a) Except as provided in subsection (b) of this section, the provisions of this part shall apply with respect to business and agricultural credit extended on or after April 1, 1980.

"(b) The provisions of this part shall not apply to any business or agricultural credit extended in any State after the effective date (if such effective date occurs on or after April 1, 1980, and prior to three years after the effective date of the Credit Deregulation and Availability Act of 1983) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to credit extensions subject to the laws of such State, except that such provisions shall apply to any credit extended on or after such date pursuant to a commitment to extend such credit which was entered into on or after April 1, 1980, and prior to such later date.

"(c) Credit shall be deemed to be extended during the period to which the provisions of this part apply if such credit extension—

"(1)(A)(i) is funded or made in whole or in part during such period, regardless of whether pursuant to a commitment or other agreement therefor made prior to April 1, 1980;

"(ii) was made prior to or on April 1, 1980, and bears or provides for interest during such period on the outstanding amount thereof at a variable or fluctuating rate; or

"(iii) is a renewal, extension, or other modification of an extension of credit made prior to April 1, 1980, and such renewal or extension or other modification is made during such period with the written consent of any person obligated to repay such credit; and

"(B)(i) has an original principal amount of $25,000 or more ($1,000 or more on or after the date of enactment of the Housing and Community Development Act of 1980 or any amount on or after the effective date of the Credit Deregulation and Availability Act of 1983); or

"(ii) is part of a series of advances if the aggregate of all sums advanced or agreed or contemplated to be advanced pursuant to a commitment or other agreement therefor is $25,000 or more ($1,000 or more on or after the date of enactment of the Housing and Community Development Act of 1980 or any amount on or after the effective date of the Credit Deregulation and Availability Act of 1983); or

"(2) is a renewal, extension, other modification or use of a credit agreement or extension made during such period, including an agreement entered during that period that contemplates future extensions of credit from time to time in which the charges that are assessed for or in connection with credit are calculated from time to time, in whole or in part, on the basis of the outstanding balance and the credit is extended not later than eighteen months after the effective date of the State law or certification.".

CONSUMER CREDIT

SEC. 3. Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public

Law 96-221) is amended by adding at the end thereof the following new part:

"PART D—CONSUMER CREDIT

"CONSUMER CREDIT

"SEC. 531. The provisions of the constitution or laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for covered charges that may be charged, taken, received or reserved shall not apply to an extension of consumer credit made by a creditor.

"DEFINITIONS

"SEC. 532. (a) As used in this part—

"(1) the term 'covered charges' means—

"(A) interest, discount, points, a time price differential, or any similar fees, charges, or other compensation paid to the creditor and arising out of the credit agreement or transaction for the use of credit or credit services. The term shall not include, however, fees, charges or other amounts paid to the creditor or arising out of the credit agreement or transaction that are paid or arise solely as the result of the failure or refusal of the debtor to comply with the terms and conditions of the debtor's agreement with the creditor, including without limitation the fact that the obligation is not repaid in accordance with the payment schedule; and

"(B) fees or charges paid for the availability of credit, payment mechanism services, or for similar purposes, including periodic, transaction and access fees;

"(2) the term 'credit' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit, all without regard to the nature of any property that might secure its repayment;

"(3) the term 'creditor' means any person that regularly makes extensions of consumer credit, which, for purposes of this definition, shall include extensions of credit that are subject to the provisions of section 501(a) of this title. A person is not a 'creditor' with respect to a specific extension of consumer credit if, except for this part, in order to assess or collect covered charges in connection with that transaction, the person would be required to comply with licensing requirements imposed under State law, unless such person is licensed under applicable State law and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanisms provided by State law; and

"(4) the term 'extension of consumer credit' means any credit extended to a natural person primarily for personal, family, or household purposes, except that it does not include credit subject to the provisions of section 501(a) or 511(a) of this title.

"APPLICABILITY

"SEC. 533. (a) Except as provided in subsection (b) of this section, the provisions of section 531 shall apply with respect to any extension of consumer credit made by a creditor on or after the effective date of the Credit Deregulation and Availability Act of 1983.

"(b)(1) The provisions of section 531 shall not apply to any extension of consumer credit in any State made on or after the effective date (if such effective date occurs on or after the effective date of the Credit Deregulation and Availability Act of 1983 and prior to a date three years after such effective date) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to extensions of consumer credit subject to the laws of such State, except that such provisions shall apply to any consumer credit extended on or after such date pursuant to an agreement to extend such credit which was entered into on or after the effective date of the Credit Deregulation and Availability Act of 1983 and prior to such later date.

"(2) Credit shall be deemed to have been extended during the period to which the provisions of this part apply, if it—

"(A) is funded or extended in whole or in part during such period, regardless of whether pursuant to a commitment or other agreement therefor made prior to that period;

"(B) was made prior to such period and bears or provides for covered charges that may vary or fluctuate during that period;

"(C) is a renewal, extension, or other modification of a credit extension made before such period and such renewal, extension or other modification is made during such period with the written consent of any person obligated to repay such credit; or

"(D) is extended in accordance with an agreement entered into prior to the effective date of the State law or certification that contemplates future extensions of consumer credit from time to time in which the covered charges are calculated from time to time, in whole or in part, on the basis of the outstanding balance and the credit is extended not later than eighteen months after the effective date of the State law or certification.

"(c) Any law or certification adopted by a State or its voters pursuant to subsection (b) of this section may specify that portion of the extensions of consumer credit made in such State, or those types or kinds of covered charges, to which the provisions of section 531 will not apply.

"INTERPRETIVE AUTHORITY

"SEC. 534. (a) The Board of Governors of the Federal Reserve System is authorized to publish Board interpretations regarding the scope and application of section 531 of this part. Upon its own motion or upon the request of any creditor, State, or other interested party which is submitted to the Board in accordance with procedures it establishes, within one hundred and twenty days the Board shall issue an official interpretation regarding the scope of section 531 and its relationship to specific provisions of State law, or shall make public a Board determination (accompanied by an appropriate explanation) that the question presented does not involve a significant issue or does not affect a substantial number of creditors or extensions of consumer credit.

"(b) No provision of the constitution or laws of any State imposing any liability, penalty, or forfeiture shall apply to any act done or omitted in good faith in conformity with any interpretation under this section by the Board, notwithstanding that, after such act or omission has occurred, such interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.".

FEDERAL CREDIT UNIONS

SEC. 4. Section 107(5)(A)(vi) of the Federal Credit Union Act (12 U.S.C. 1757(5)(A)(vi)) is amended to read as follows:

> "(vi) rates of interest shall be established by the board of directors of the Federal credit union;".

EFFECTIVE DATE

SEC. 5. This Act shall take effect upon its enactment.

The **Chairman**. Mr. Secretary, please proceed.

STATEMENT OF BERYL SPRINKEL, UNDER SECRETARY FOR MONETARY AFFAIRS, U.S. DEPARTMENT OF THE TREASURY, ACCOMPANIED BY GORDON EASTBURN, DIRECTOR, OFFICE OF FINANCIAL INSTITUTIONS POLICY

Mr. **Sprinkel**. Mr. Chairman and members of this distinguished committee, I appreciate this opportunity to review with you S. 730, the Credit Deregulation and Availability Act of 1983, a bill to remove State and Federal usury ceilings on credit transactions.

This legislation is important to consumers and important to the efficient and equitable operation of our financial markets.

S. 730 would broadly preempt State and Federal usury ceilings on business, agriculture and consumer loans, but would include a provision which would retain State consumer protection laws and lender licensing requirements. Such laws and regulations ensure that consumers receive credit terms that are fair and fully disclosed.

In his April 6 testimony before this committee on the current economic and competitive conditions in our financial markets, the Secretary of the Treasury testified in favor of preempting usury ceilings on all types of credit. He stated that "the administration believes that usury ceilings only distort financial markets and credit flows and do not reduce the cost of credit to the economy."

Thus, the administration strongly supports the fundamental principles underlying S. 730. It favors the broad approach of this bill, which would further the deregulation of the cost of credit begun by the Depository Institutions Deregulation and Monetary Control Act of 1980. In addition, the administration strongly supports the provision in S. 730 which would give the States the ability to override any usury ceiling preemption for a 3-year period after the effective date of the act and which would continue to exempt from coverage State usury laws enacted under the similar override provision of the Deregulation Act of 1980.

I would like to take this opportunity to address, in a general way, the adverse impact usury ceilings have on our economy.

ADVERSE IMPACT USURY CEILINGS HAVE ON ECONOMY

Although usury laws are intended to protect small and low-income borrowers from unscrupulous lenders who might otherwise charge excessive interest rates, they have unintended and adverse effects on borrowers, financial institutions, and the public at large, particularly during periods of inflation and contracted credit availability. When market interest rates are above usury ceilings, many borrowers are unable to obtain loans from commercial banks or other financial institutions. Those first denied credit are generally the high-risk and low-income borrowers. When lenders are unable to charge rates sufficiently to yield a reasonable rate of return, they generally stop or substantially curtail lending to such marginal borrowers. Should a lender's cost of funds exceed the prevailing usury ceilings, all consumer lending may be expected to cease. Borrowers are then forced to rely on unprincipled lenders for loans made above usury rate limits or seek nonmarket sources of credit, such as family or friends. Alternatively, where State ceilings are too restrictive, borrowers may resort to out-of-State sources for necessary credit.

Equally important, usury ceilings and other arbitrary restrictions that limit credit availability tend to affect employment adversely and dampen economic growth. For example, in States with constitutionally mandated interest rate limits, the economy almost always grows more slowly than the national economy. When market interest rates rise above the State usury ceilings. In high interest rate periods, many automobile dealers, appliance stores, and other businesses that rely on consumer credit go out of business or have to move across the State's borders. Clearly, more than just inefficiency and inconvenience result from such locational pattern changes.

Usury ceilings are also inconsistent with congressional efforts to restructure our financial institutions which began with the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980.

This act, along with providing for the phaseout of federally administered interest rate ceilings on deposits, expanded the asset powers of thrift institutions to include consumer lending. For example, one of the reasons Congress authorized consumer lending activities at savings and loan associations was to help alleviate the severe profit volatility problems of these institutions due to the maturity imbalance between their assets and liabilities. It was believed that the shorter maturity of consumer loans, compared with the maturity of mortgage loans, would provide more asset yield flexibility at these institutions and thus reduce profit squeezes during high interest rate periods. The Garn-St Germain Depository Institutions Act of 1982 built upon this concept when it expanded the consumer lending authority of savings and loan associations and gave them limited commercial lending powers.

However, these institutions are discouraged from taking advantage of their newly acquired powers when usury ceilings require them to make loans at interest rates that are below the cost of their deposits. With the eventual elimination of all deposit interest rate limitations, changes in the average cost of funds to all depository institutions will reflect more closely changes in market rates of interest. If banks and other financial institutions are to maintain their long-term viability, they must be able to adjust their interest charges and fees in response to changes in their cost of funds and operating expenses. The ability of depository institutions to pay market rates to depositors is necessarily dependent upon simliar flexibility in their authority to charge such rates on their loans.

Finally, State usury ceilings are quickly becoming ineffective in a financial system which is increasingly national in scope. Individuals in any State may use bank credit cards issued by banks in another State and therefore be subject to the less restrictive usury ceilings. Similarly, lenders in a State subject to low usury limits may purchase out-of-State loans or may sell other loanable funds in unregulated national markets, such as the interbank Federal Funds Market. These examples indicate that some individuals and institutions are able to circumvent or adapt to usury ceilings, while others, usually the poor or less sophisticated borrowers, suffer from their impact. Since changes in the financial markets have made State control of the cost of credit ineffective, the administration supports a Federal preemption of all usury ceilings as long as the preemption includes a provision which gives States an opportunity to reinstate the usury ceiling any time within the next 3 years.

USURY LAWS DESIGNED TO PROTECT BORROWERS

Usury laws historically have been designed to protect borrowers from unfair lending practices. The administration feels, however, that current State and Federal consumer protection laws satisfy this important social goal more effectively and are less disruptive to the financial markets than usury ceilings. This committee will hear evidence of unscrupulous lending practices in States which have enacted broad credit deregulation laws. Increased consumer sophistication and competition among financial institutions in the consumer loan market provides sufficient protection to consumers against unfair interest rates in most parts of the country. However, in those areas of the country where credit markets are not yet reasonably competitive, a need remains for specific safeguards to protect the unwary borrower.

Therefore, legislation preempting State usury ceilings should include specific provisions retaining the consumer safeguards developed by States. The area of proper consumer safeguards involves very technical and complex issues. And we would hope that Congress would consult with experts on the subject in the Federal regulatory agencies. The administration supports the proposal in S. 730 to repeal the statutory provision maintaining Federal rate ceilings on Federal credit union loans. Since Federal credit unions must pay market rates to attract deposits, they should not be limited as to the rates they can charge on loans.

Current Federal law states that federally insured depository institutions, when setting loan rates, may charge the greater of the rate of interest allowed by a State where the institutions are located or a rate not more than 1 percent in excess of the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such bank is located.

While this alternative Federal ceiling is an advantage where State usury ceilings require lower rates, in general the administration believes that any federal ceiling is as inappropriate as any State ceiling.

In the current environment of low inflation and declining interest rates, fixed-rate usury laws are usually of little significance. However, in high-inflation, high-interest-rate periods, they tend to hurt borrowers by restricting the availability of credit or by encouraging abuses by unregulated lenders. In addition, they are inconsistent in any environment with recent legislation providing for the phase-out of interest rate ceilings on deposits, which will result in savers earning market rates on their deposits. If institutions are to pay market rates to savers, they must be able to charge market rates to borrowers or they will not be able to remain viable.

In conclusion, since the administration supports the removal of all usury ceilings, we are supportive of S. 730, including those provisions that contain the 3-year state override and the retention of State laws concerning consumer safeguards.

Mr. Chairman, that concludes my testimony. I'll be pleased to answer any questions the committee may have.

[Complete statement follows:]

FOR RELEASE UPON DELIVERY
Expected at 9:00 a.m.
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STATEMENT OF
THE HONORABLE BERYL W. SPRINKEL
UNDER SECRETARY FOR MONETARY AFFAIRS
U.S. TREASURY DEPARTMENT
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

Mr. Chairman and members of this distinguished Committee, I appreciate this opportunity to review with you S. 730, the "Credit Deregulation and Availability Act of 1983", a bill to remove state and Federal usury ceilings on credit transactions. This legislation is important to consumers and important to the efficient and equitable operation of our financial markets.

S. 730 would broadly preempt state and Federal usury ceilings on business, agriculture and consumer loans but would include a provision which would retain state consumer protection laws and lender licensing requirements. Such laws and regulations insure that consumers receive credit terms that are fair and fully disclosed.

In his April 6 testimony before this Committee on the current economic and competitive conditions in our financial markets, the Secretary of the Treasury testified in favor of preempting usury ceilings on all types of credit. He stated that the Administration believes that usury ceilings only distort financial markets and credit flows and do not reduce the cost of credit to the economy.

Thus the Administration strongly supports the fundamental principles underlying S. 730. It favors the broad approach of this bill which would further the deregulation of the cost of credit begun by the Depository Institutions Deregulation and Monetary Control Act of 1980. In addition, the Administration strongly supports the provision in S. 730 which would give states the ability to override any usury ceiling preemption for a three year period after the effective date of the Act and which would continue to exempt from coverage state usury laws enacted under the similar override provision of the Deregulation Act of 1980.

IMPACT OF USURY CEILINGS

I would like to take this opportunity to address in a general way the adverse impact usury ceilings have on our economy.

Although usury laws are intended to protect small and low-income borrowers from unscrupulous lenders who might otherwise charge excessive interest rates, they have unintended and adverse effects on borrowers, financial institutions, and the public at large, particularly during periods of inflation and contracted credit availability. When market interest rates are above usury ceilings, many borrowers are unable to obtain loans from commercial banks or other financial institutions. Those first denied credit are generally the high-risk and low-income borrowers. When lenders are unable to charge rates sufficient to yield a reasonable rate of return, they generally stop or substantially curtail lending to such marginal borrowers. Should a lender's cost of funds exceed the prevailing usury ceilings, all consumer lending may be expected to cease. Borrowers are then forced to rely on unprincipled lenders for loans made above usury rate limits or seek nonmarket sources of credit such as family or friends. Alternatively, where state ceilings are too restrictive, borrowers may resort to out-of-state sources for necessary credit.

Equally important, usury ceilings and other arbitrary restrictions that limit credit availability tend to affect employment adversely and dampen economic growth. For example, in states with constitutionally mandated interest rate limits the economy almost always grows more slowly than the national economy when market interest rates rise above the state usury ceilings. In high interest rate periods many automobile dealers, appliance stores and other businesses that rely on consumer credit go out of business or have to move across the state's borders. Clearly, more than just inefficiency and inconvenience result from such locational patterns.

PAST DEREGULATION EFFORTS

Usury ceilings are also inconsistent with Congressional efforts to restructure our financial institutions which began with the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980. This Act, along with providing for the phaseout of Federally administered interest rate ceilings on deposits, expanded the asset powers of thrift institutions to include consumer lending. For example, one of the reasons Congress authorized consumer lending activities at savings and loan associations was to help alleviate the severe profit volatility problems of these institutions due to the maturity imbalance between their assets and liabilities. It was believed that the shorter maturity of consumer loans (compared with the maturity of mortgage loans) would provide more asset yield flexibility at these institutions and thus reduce profit squeezes during high interest rate periods. The Garn-St Germain Depository Institutions Act of 1982 built upon this concept when it expanded the consumer lending authority of savings and loan associations and gave them limited commercial lending powers. However, these institutions are discouraged from taking advantage of their newly acquired powers when usury ceilings require them to make loans at interest rates that are below the cost of their deposits. With the eventual elimination of all deposit interest rate limitations, changes in the average cost of funds to all depository institutions will reflect more closely changes in market rates of interest. If banks and other financial institutions are to maintain their longterm viability, they must be able to adjust their interest charges and fees in response to changes in their cost of funds and operating expenses. The ability of depository institutions to pay market rates to depositors is necessarily dependent upon similar flexibility in their authority to charge such rates on their loans.

Finally, state usury ceilings are quickly becoming ineffective in a financial system which is increasingly national in scope. Individuals in any state may use bank credit cards issued by banks in another state and therefore be subject to the less restrictive usury ceilings. Similarly, lenders in a state subject to low usury limits may purchase out-of-state loans or may sell their loanable funds in unregulated national markets, such as the interbank Federal funds market. These examples indicate that some individuals and institutions are able to circumvent or adapt to usury ceilings, while others (usually the poor or less sophisticated borrowers) suffer from their impact. Since changes in the financial markets have made state control of the cost of credit ineffective, the Administration supports a Federal preemption of all usury ceilings as long as the preemption includes a provision which gives states an opportunity to reinstate the usury ceiling anytime within the next three years.

CONSUMER PROTECTION

Usury laws historically have been designed to protect borrowers from unfair lending practices. The Administration feels, however, that current state and Federal consumer protection laws satisfy this important social goal more effectively and are less disruptive to the financial markets than usury ceilings. This Committee will hear evidence of unscrupulous lending practices in states which have enacted broad credit deregulation laws. Increased consumer sophistication and competition among financial institutions in the consumer loan market provide sufficient protection to consumers against unfair interest rates in most parts of the country. However, in those areas of the country where credit markets are not yet reasonably competitive, a need remains for specific safeguards to protect the unwary borrower.

Therefore, legislation preempting state usury ceilings should include specific provisions retaining the consumer safeguards developed by states. The area of proper consumer safeguards involves very technical and complex issues and we would hope that Congress would consult with experts on this subject in the Federal regulatory agencies.

A FEDERAL USURY CEILING

The Administration supports the proposal in S. 730 to repeal the statutory provision maintaining Federal rate ceilings on Federal credit union loans. Since Federal credit unions must pay market rates to attract deposits, they should not be limited as to the rates they can charge on loans.

Current Federal law states that Federally insured depository institutions when setting loan rates may charge the greater of the rate of interest allowed by a state where the institutions are located or a rate not more than one percent in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such bank is located. While this alternative Federal ceiling is an advantage where state usury ceilings require lower rates, in general the Administration believes that any Federal ceiling is as inappropriate as any state ceiling.

RECOMMENDATION

In the current environment of low inflation and declining interest rates, fixed-rate usury laws are usually of little significance. However, in high inflation/high interest rate periods they tend to hurt borrowers by restricting the availability of credit or by encouraging abuses by unregulated lenders. In addition, they are inconsistent in any environment with recent legislation providing for the phase out of interest rate ceilings on deposits which will result in savers earning market rates on their deposits. If institutions are to pay market rates to savers, they must be able to charge market rates to borrowers or they will not be able to remain viable.

In conclusion, since the Administration supports the removal of all usury ceilings, we are supportive of S. 730, including those provisions that contain the three year state override and the retention of state laws concerning consumer safeguards.

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Mr. Chairman, that concludes my testimony. I will be pleased to answer any questions the Committee may have.

The CHAIRMAN. Thank you, Mr. Secretary.

On page 2 of your statement, you note the adverse impact that usury ceilings have on economic growth and the fact that during high rate periods businesses will move across State lines as the result of such ceilings. You state, and I quote, "More than just inefficiency and inconvenience result from such locational patterns."

Would you discuss other economic implications of competitors having to make business decisions based on binding rate ceilings rather than market forces?

Mr. SPRINKEL. Some competitors will be unable to get financing, or some of the customers will be unable to get financing. If their sales go down and their profits are eliminated, they will either have to move into a State where usury ceilings do not exist or find a more expensive way of attracting clients. This means uprooting businesses, people, jobs. It creates an inefficiency that, in my opinion, could readily be avoided, if we did not have the usury ceiling. Both the borrower and the business that sells goods or services to that borrower, are at a disadvantage if they can't get credit.

The CHAIRMAN. Like Arkansas, with the 10 percent constitutional limit, where it's simply dried up a good deal of the Arkansas market and made it virtually impossible for them during the period of high interest rates.

Over the long run, wouldn't you assume that interest rate ceilings rather than reducing the cost to borrowers would increase costs not only to borrowers but to consumers as well?

Mr. SPRINKEL. Yes sir, I would, because it leads to efforts to get funds which ultimately are more costly than the funds they would have been able to obtain if the ceiling were not there. Incidentally, Mr. Chairman, there are some good studies, that have attempted to measure the impact of the usury ceilings. One was a study written by Harold Nathan, entitled "Economic Analysis of Usury Laws: An Empirical Study," published in the Journal of Bank Research in 1979. Another by Richard Gustely and Harry Johnson, entitled

"Impact of the Tennessee Constitutional Usury Limit on the Tennessee Economy," written in June 1977 and published by the University of Tennessee.

These studies that we have found certainly are consistent with what you would expect, based on the disincentives that result from the usury ceilings.

The CHAIRMAN. That's why it is puzzling to me. Later this morning, we will have a panel of consumer groups who will testify against the legislation. I certainly don't question their sincerity at all. I can certainly understand their opposition to high interest rates. I don't know anyone who has enjoyed the high interest rates of the last few years. Particularly in the last 2 or 3 years that I have been involved in this issue, it has produced such abundant information, that rather than helping the situation, usury ceilings have compounded it, with increased costs. So, I have a difficult time understanding all of the opposition, when basically the people you are hurting the most are the unsophisticated borrowers, the lower income borrowers, and so on. The big businesses and the sophisticated and higher income groups, can always find someplace to get their money. They will go out of State where they have the contacts.

So it is puzzling to me. It seems to me that the people who have been hurt the very most by interest rate ceilings and usury ceilings have been the very people that they are intended to protect.

Would you agree with that?

Mr. SPRINKEL. Yes, sir, I do agree with that. Of course, usury ceilings are not a new phenomenon. They go back to biblical times and, I am certain, before that. The objective always is to try to help the poor that may not have the alternatives, but as is frequently the case in economics, the second-round effect is more important than the first-round effect. And surely, you may reduce the cost of credit; but credit has an infinite cost from the standpoint of the individual who is trying to get it and cannot.

So there is sometime a difference between objectives of laws and results of laws. And I think usury ceilings are an excellent example of this.

CONTROL LOAN SHARKS

The CHAIRMAN. Weren't they also originally trying to control the loan sharks and the people who were really trying to gouge? They didn't buy ads in the newspapers anyway. When you are dealing with market rates, everything is pretty competitive. I don't see how usury ceilings, in any event, protect from that kind of back-street loan. The hole-in-the-wall type of operations are not the ones who advertise, have shareholders, and all of that. So I am not sure that we even begin to touch that kind of a market, where many of the poorer people in our society are driven if they can't obtain loans from normal sources, such as banks, savings and loans, credit unions, or finance companies, which are well known, have business licenses and are subject to regulations.

It would seem to me that usury ceilings are just benefiting that loan-shark type of individual. These ceilings are one of the best things they have got going for business. If these poorer people don't have the alternatives, that is where they are going to go.

Mr. SPRINKEL. It is very difficult to get a record of that sort of transaction.

The CHAIRMAN. Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

I want to thank you for your vigorous statement of support for the legislation. I think it is very desirable in many ways, but I would like to ask you a couple of questions on it.

Although usury ceilings tend to dry up credit, some economists feel they sometimes serve a useful purpose during periods when the Federal Reserve is trying to slow down the economy. With no usury ceilings, interest rates will have to rise higher to achieve the same degree of restraint.

Do you think that is the case or not?

Mr. SPRINKEL. Obviously, it is a debatable issue. Some economists contend that, but I don't believe it. The way monetary policy slows down economic activity, of course, is to slow the rate of growth of money. In the short run, that may lead to an increase in interest rates. In the long run, it is likely to do the opposite. There is a close relationship between the rate of growth in money and the rate of growth in total spending. So I would not expect that a usury ceiling, which would distort the allocation of credit, would have a significant bearing on either the total credit outstanding, because there are other ways you can extend credit, or upon money supply growth. Therefore I would take the contrary view on that particular issue.

POSSIBLE ADVANTAGE TO CREDITORS

Senator PROXMIRE. In 1972, I served on the National Commission on Consumer Finance. That Commission came to a similar conclusion about usury that we have in this bill, and you've expressed so well this morning. But the Commission also recommended that if usury ceilings are raised or eliminated, we must also consider revising creditors' remedies that may give an undue advantage to creditors.

Do you have any view on that?

Mr. SPRINKEL. Revising what, sir?

Senator PROXMIRE. Creditors' remedies.

Mr. SPRINKEL. We have suggested that consumer protection laws should be retained. It is a very complicated area, and some of them do provide for refunds for some costs if an error is created. I have a long list of the kinds of consumer safeguards that are in the laws and they are all creditors' remedies. It depends on the State, but these remedies include laws limiting charges that may be assessed for resolving errors, or providing for removal of charges on erroneously billed accounts and a long list of other safeguards. I think it is appropriate that those be retained.

Senator PROXMIRE. I have got in front of me a statement by a witness who is going to appear this afternoon, Ellen Broadman. She says:

> S. 730 Would abolish all State laws that limit interest rates or certain other charges for consumer credit. Even State laws that allow interest rates significantly

> above market levels and therefore only prohibit unconscionable charges, would be erased. This bill would legalize loan sharking and invite a new era of consumer abuses. The Consumers Union finds the broad sweep of this bill wholly unwarranted in any circumstances and especially, now given that most States have increased their usury ceilings to keep abreast of market changes and that market interest rates are generally below usury limits.

What is your reaction to that?

Mr. SPRINKEL. Their objective, obviously, is to have low interest rates, and I couldn't agree more. To the extent we have low interest rates, the usury ceilings that exist will not interfere.

Senator PROXMIRE. Can I interrupt. It is not just a matter of low interest rates. It is a matter of loan sharking and other abuses.

Mr. SPRINKEL. I am coming to that, sir.

Senator PROXMIRE. In other words, someone who is charging 50 percent or 100 percent.

Mr. SPRINKEL. The point is that if rates are low, the usury ceilings will be above the interest rates and, therefore, ineffective. Let's suppose the rates were high, because we have inflation, and market rates are in excess of the usury ceiling. The only time we are concerned about the usury ceilings is when market rates tend to be above them. In that case, the small borrower would be unable to get credit, except from unusual sources, including loan sharks. So it seems to me, as Senator Garn suggested, that usury ceilings aid and abet the very activity that you would like to avoid.

Senator PROXMIRE. I agree with the notion that we shouldn't have usury ceilings. I am just wondering if we shouldn't have a more effective system of protecting people who for one reason or another have to borrow outside of the regular system. I am not talking about people who borrow from an S&L or credit union or bank. I am talking about people who can't borrow there. They borrow outside these institutions. They have no protection, if we knock out this limitation.

CONSUMER SAFEGUARDS

Mr. SPRINKEL. In addition to the consumer safeguards which I mentioned, which exist in many states, in my opinion the main protection to a borrower is having alternative lenders available, so that he can shop for the best rates. If the marketplace is reasonably efficient, it does, in and of itself, provide that kind of protection with alternatives. There may be a number of communities where there are very few choices, in which case the safeguards would be very useful. But in general, I trust the protection provided by the market. As long as I have an alternative, I am not shoved down to a loan shark.

Senator PROXMIRE. Let me ask you this then.

She goes on to say:

> If this web of usury limits is erased, basic consumer protections are needed to protect individuals against excessive fees, especially fees that do not appear in the annual percentage rate, and to protect borrowers against abusive creditor remedies on default.

Truth-in-Lending provides, of course, some protection here.

Mr. SPRINKEL. They insist on a particular way of stating the interest rate, which I think is useful, because many people do not recognize that a discounted rate is probably twice what the stated rate implies: And there is a necessity under that law to inform the people. The way to assure that markets work efficiently is to provide information.

Senator **Proxmire**. But she says that some fees would not have to appear in the annual percentage rate, and therefore, you wouldn't get the protection of Truth-in-Lending.

How about the so-called "plain English requirements"? In other words, requiring that the contractual terms be stated in simple language that is easy to understand? Without that many people are puzzled by language that you would understand and that other experts would understand, but that the typical borrower may not.

Mr. **Sprinkel**. Many of the States do have such a requirement. Since I am not a lawyer, I find it very useful to have it stated in plain English, because if it isn't stated in plain English, it is usually in legal jargon, which may not be readily understandable by the layman.

Senator **Proxmire**. Should we incorporate something like that into the law itself?

Mr. **Sprinkel**. I really am doubtful, because the States do have the option of incorporating that type of safeguard into their laws. They even have an option within a 3-year period of reinstating the ceiling, if they want. I don't think that is a desirable option, but I believe in States' rights. But I don't see why we should mandate all consumer safeguards at the Federal level.

Senator **Proxmire**. OK. One other question.

She also says:

> Under S. 730, creditors could assess virtually any charges for consumer credit, including charges that might not be included in the annual percentage rate APR disclosure. For example, with credit cards, lenders could charge unlimited annual fees, transaction fees or other one-time charges that are never factored into the APR, which consumers use to comparison shop.

In other words, you take this off, and then you don't provide the kind of requirements for disclosing annual percentage rates, so the consumer can protect himself.

Mr. **Sprinkel**. Legally, they may charge any fee but, in fact, they can't, because there is a market constraint. A particular lender cannot get away with charging a rate significantly above the rate charged by other lenders. So, again, I would argue, the market offers protection for the borrower.

Senator **Proxmire**. I am inclined to agree with you, for most people who are well-educated and who are sophisticated business people and others, but for the person who is not, it seems to me we might want to think about the possibility of seeing if we could work in further protections in the law. We have to be careful about that, but that is just something which, it seems to me, would provide some additional safeguards.

Mr. **Sprinkel**. I certainly agree that safeguards can be useful, but I get very nervous when we talk about setting rates, because when market rates change, they have the adverse effects that I suggested in my testimony.

Senator **Proxmire**. Thank you, Mr. Chairman.

The **Chairman**. Senator Gorton.

Senator GORTON. Mr. Secretary, you made a good, I think it might be called standard case as long ago as the 1972 report about the economic desirability of this policy.

OVERRIDING STATE LAWS

I noticed nothing in your statement on the justification for overriding State laws in this bill. Even granting the validity of everything you said from the point of view of economics, aren't these decisions about who should receive credit and the like appropriately within the purview of the people of the various States and their elected representatives?

Mr. SPRINKEL. Yes, sir. They have the right, as I understand it, to refuse to go with this override, provided they do it within 3 years.

There were with the earlier bill, as you know, I believe 14 States that overrode the Federal laws and set their own usury ceilings. I think they had a right to do so. Now, they will have some adverse effects if they do, but that's their right.

Senator GORTON. Of course they don't need this bill to get rid of those adverse effects right now, do they?

Mr. SPRINKEL. No, not all States will override. As I indicated, I believe there are 14 that reimposed usury limits. I would not expect most of the States to do so, especially given the adverse effect on the economic development of the State.

Note therefore, I think it's very sensible to support this particular bill which would create freer markets in most States.

Senator GORTON. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hawkins.

POTENTIAL LOSS FROM FOREIGN LOANS

Senator HAWKINS. Welcome, Mr. Sprinkel. Last March my subcommittee held hearings, as you may recall, on the question of high consumer interest rates and one area of concern that I thought remained to be answered involves the effect of the potential loss from foreign loans may or may not have on consumer interest rates.

The Vice Chairman of the Federal Reserve, Preston Martin, told my subcommittee he doesn't disagree that foreign losses could be a factor among others in the slowness of consumer bank commercial loan rates to decline, and another witness, Mr. Schechter of the AFL, told the subcommittee that there's evidence that some financial institutions have held consumer interest rates artificially high in order to generate earnings to cover anticipated losses on foreign and domestic loan portfolios.

He felt that for a more definitive answer we needed more detailed information on domestic and foreign loan operations.

I was hopeful that you and the bank regulators would be able to give us more detailed information on the relationship between potential losses on foreign and domestic loans and consumer interest rates.

Treasury Secretary Donald Regan is reported to have told the House Foreign Affairs Committee "there's no doubt about it, banks are trying to maximize their profits by keeping interest rates high for as long as they can."

Do you think it's the view of the Treasury that banks are continuing to keep rates at artificially high levels?

Mr. **Sprinkel**. We must recognize that historically certain rates have been sluggish in adjusting to changes in market conditions. Mortgage loan rates traditionally have lagged; they're now moving down after holding at very high levels for many months. Consumer credit rates also tend to lag.

By far the most important factor in determining the level of interest rates, whatever the rate in my opinion, is the rate of inflation. Over time if we're successful in holding the inflation rate at present or even slightly higher levels, we'll find all of the rates coming down.

The justification for arguing that losses have a bearing on the rate charged presumably refers to a cost of doing business, and ultimately those costs must be borne by the business that actually is done by the institution. So I would agree that those costs probably have an impact. The losses have not yet been massive in the international area, but there is a potential in that sector of total loans. So yes, it's probably keeping rates a little higher than they would have been otherwise, but over time——

Senator **Hawkins**. Give me a definition of "over time." You've used that word three times. Six months?

Mr. **Sprinkel**. I'm really talking about inflationary expectations. Experts differ as to how long they might persist, but I would say 3 or 4 years.

Senator **Hawkins**. Three or four years?

Mr. **Sprinkel**. Yes, ma'am. If we look for example at the level of rates today in comparison to the inflation rate today, the real rate, that particular version of the real rate, is very high. It's unsustainably high. This suggests to me that the marketplace does not believe that this administration and this Congress will effectively limit budget expenditures and effectively limit money growth, and hence keep inflation at these levels.

Now, the longer we stick to it, the more we'll all be convinced that we mean it and that in fact inflation will stay low and interest rates will keep coming down. But it does not happen instantaneously. We've had 15-plus years of a pattern of inflation receding in recessions but then going back to new highs with the next recovery. People don't believe it will be different this time.

The only thing that will make it different is action by the Congress and the administration. That will convince the market we can do it. It takes a while to convince the marketplace.

Senator **Hawkins**. Do banks have sufficient reserves against foreign loan losses in your opinion?

Mr. **Sprinkel**. You should ask the regulators. I understand they're coming along shortly, and that is a field of their expertise. [Laughter.]

Senator **Hawkins**. That's what I call passing the buck.

The **Chairman**. May I just interject, Senator Hawkins, that we had more than 3 hours of hearings yesterday on that subject with the regulators, and we'll be discussing that at great length.

Senator HAWKINS. I just wanted to hear what Mr. Sprinkel felt about it.

The CHAIRMAN. We heard about that at yesterday's hearings.

Senator HAWKINS. So it is called passing the buck. I'll ask the other questions then to the others, since you do not have an opinion on it and the record will reflect that if the banks are to suffer losses in one area, in your opinion, will the banks try to make up for those losses in another area?

Mr. SPRINKEL. Most private institutions including banks try to maximize their overall profits; there's no doubt about that. The question is, why don't they make even more money? There's a limit to how high they can raise rates because of the alternative sources of funds available to borrowers, and I would expect them under most circumstances to try to maximize their profits; that's the way our system works.

It happens in the production of automobiles, in the production of steel, and in the provision of credit services. To the extent they have losses, they will still attempt to minimize the losses and maximize profits. So that, yes, they will try to make as many profits as they can. We do not have excess profit taxes, we have a market which prevents profits from becoming excessive over time.

Senator HAWKINS. Are the consumers and small borrowers in the weakest position to protect themselves against high interest rates at the present time?

Mr. SPRINKEL. If there are usury ceilings and high interest rates, it will be the small borrowers, the poor, the ones who do not know about the alternative sources of credit, that will find it very difficult to get funds. If they're able to get funds from conventional institutions, they will not be at as great a disadvantage.

Senator HAWKINS. So, they can borrow money at higher interest rates which will make them not so poor?

Mr. SPRINKEL. It will not make them as poor as if they couldn't borrow money at all. Some people have a legitimate need for credit and if they can't get it because of the usury ceilings, they're worse off than they would be if they could get the money at a slightly higher rate.

Senator HAWKINS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hecht.

Senator HECHT. Mr. Chairman, I agree that there should not be ceilings; no questions.

The CHAIRMAN. Thank you. We do have about 16 more witnesses, so we thank you very much for your testimony today and we will call up the next panel.

Mr. SPRINKEL. Thank you very much, Mr. Chairman.

The CHAIRMAN. If we could have come to the table Hon. Charles Partee of the Federal Reserve Board; Todd Conover, Comptroller of the Currency; Richard Pratt, Chairman of the Federal Home Loan Bank Board; Edgar Callahan, Chairman of the National Credit Union Administration; and Stanley C. Silverberg, Director, Division of Research and Strategic Planning, Federal Deposit Insurance Corporation.

May I take just a moment to say before we start to Chairman Pratt—I assume this may be his last appearance before the Banking Committee; in any event let me take this opportunity to say how much I personally enjoyed working with you the last 2 years.

I'm disappointed that you are leaving the chairmanship of the Federal Home Loan Bank Board, because I think you have been in a position in the last 2 years of having the most difficult task with the problems of the savings and loans that any chairman of that Board has faced. Under those very difficult circumstances, I think you've done as good a job as it is possible to do.

I want to take this opportunity to state that publicly to you, and for the record, and wish you well in whatever you decide to do in the great outside civilian world away from government.

Senator PROXMIRE. Mr. Chairman, would you yield on that? You're praising a man you know is a dear friend of yours—he's from the same State. But I want to say I want to join you because I think Mr. Pratt was exactly the right man at the right place at the right time.

We needed a strong person at this time, a very, very difficult transition for S&L's at the time when we managed to tax their abilities and tax the regulators' ability.

I think you've done a first-class job.

Mr. PRATT. I just want to say that I appreciate these sentiments of the Senators and to say that this committee and its leadership and the total committee and its ability and willingness to do what need to be done, I think is a major reason that the thrifts are able to be here today and be competitive and have bright futures.

So, I can't tell you how much easier you made my job and I appreciate that.

The CHAIRMAN. Governor Partee.

STATEMENT OF J. CHARLES PARTEE, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM; C. TODD CONOVER, COMPTROLLER OF THE CURRENCY; RICHARD T. PRATT, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD; EDGAR F. CALLAHAN, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION BOARD; AND STANLEY C. SILVERBERG, DIRECTOR, DIVISION OF RESEARCH AND STRATEGIC PLANNING, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. PARTEE. Mr. Chairman, I'm pleased to appear before this committee on behalf of the Federal Reserve to discuss the Federal preemption of State usury laws governing interest rates on business, agriculture and consumer loans.

The Board has long been concerned about the adverse impact of usury ceilings on the availability of funds in the local credit markets.

Usury laws that impose unrealistically low limits reduce the supply of credit to local borrowers by encouraging lenders to channel funds into other investments or to geographic areas where they can earn market rates of return.

Alternatively, to compensate for the low-interest rates that are legally permissible, lenders may tighten nonrate lending terms and credit standards, thus in effect rationing available credit in socially undesirable ways.

Also, financial institutions can often restructure the types of loans they make without altering the use borrowers make of the funds. In sum, since money is fungible, it will tend to flow in one way or another to the credit markets offering the highest economic rates of return.

Given the rapid deregulation of interest rates paid by depository institutions moreover, the cost of funds to financial institutions in local communities has become increasingly sensitive to national money market developments. This creates an even stronger incentive for these institutions to earn a competitive return on their assets.

Despite the Board's basic opposition to artificial constraints on interest rates, we have had reservations about Federal intrusion into an area traditionally regulated by the individual States in this regard.

Retention of a provision clearly permitting States to override a Federal preemption of their ceilings seems an important minimal protection of States' prerogatives. Information collected by Board staff indicates that as of the middle of last year a dozen States had at least partially overridden the Federal law imposed on them by the Monetary Control Act of 1980. Those States that were most restricted by usury ceilings generally did not act to override the preemption; in fact many States have moved to relax the regulation of interest rates following the passage of the Deregulation Act. Those States that have not relaxed or were slow to relax their usury ceilings, particularly ceilings on consumer loans, frequently have suffered some costs as financial institutions increasingly have shifted some lending operations to other States that have no usury constraints.

The Board believes that interest rates are best determined in markets unconstrained by arbitrary rate ceilings of any kind. In the past we have considered a variable rate ceiling as a preferable alternative to fixed rate State usury ceilings. However, the Board has viewed the use of the Federal Reserve discount rate as an index inappropriate for a variable interest rate ceiling at either the Federal or State level. Thus the current bill is to be commended for not tying a Federal variable ceiling to the discount rate.

To summarize, the Board continues to believe that State action rather than Federal law should prevail wherever possible in dealing with the problem of fixed rate usury ceilings. Many States have acted since 1980 to reduce the constraining effect of the usury ceilings on credit availability and financial conditions have eased recently to the point where usury ceilings generally are not now a binding constraint. Although these factors weaken the current urgency of the matter, they do not eliminate the underlying need for further action to relax interest rate ceilings. If the Congress determines that this should be done through Federal preemption, the Board would urge first that the States continue to be permitted whatever degree of override their circumstances seem to dictate; and second, that the Federal Reserve discount rate not be used in any variable ceiling rate scheme.

Thank you, Mr. Chairman.

[The complete statement follows:]

PREPARED STATEMENT OF J. CHARLES PARTEE, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I am pleased to appear before this Committee on behalf of the Federal Reserve to discuss a federal preemption of state usury laws governing interest rates on business, agricultural and consumer loans. As you know, a temporary preemption of business and agricultural rate ceilings, which was passed as a provision of the Depository Institutions Deregulation and Monetary Control Act of 1980, expired on April 1 of this year. The preemption has authorized lenders to charge a rate up to 5 percent above the Federal Reserve discount rate on business and agricultural loans of $1,000 or more in those states with ceilings less than this variable limit. Rate ceilings on consumer loans were not subject to a federal preemption under the Act. Rate ceilings on mortgage credit were preempted permanently except in those states that acted to override the preemption prior to April 1. The bill currently before this Committee recommends a permanent federal preemption of state usury ceilings on business, agricultural, and consumer credit without imposing an alternative federal limit tied to the discount rate or any other interest rate.

The Board has long been concerned about the adverse impact of usury ceilings on the availability of funds in local credit markets. Usury laws that impose unrealistically low limits tend to reduce the supply of credit to local borrowers by encouraging lenders to channel funds into other investments or to geographic areas where they can earn market rates of return. Alternatively, to compensate for the low interest rates that are legally permissable, lenders may tighten nonrate lending terms and credit standards, thus in effect rationing available credit in socially undesirable ways. Also, financial institutions can often restructure the types of loans they make without altering the use borrowers make of the funds. For example, rather than offer traditional consumer loans subject to an interest rate limit, lenders may offer junior mortgages which typically are not subject to a usury law, but which nevertheless add to the generalized purchasing power of consumers.

In sum, since money is fungible, it will tend to flow, in one way or another, to the credit markets offering the highest economic rates of return. Given the rapid deregulation of interest rates paid by depository institutions, moreover, the cost of funds to financial institutions in local communities has become increasingly sensitive to national money market developments. This creates an even stronger incentive for these institutions to earn a competitive return on their assets.

Despite the Board's basic opposition to artificial constraints on interest rates, we have had reservations about federal intrusion into an area traditionally regulated by the individual states. In this regard, retention of a provision clearly permitting states to override a federal preemption of their ceilings seems an important minimal protection of state prerogatives. Information collected by Board staff indicates that, as of the middle of last year, a dozen states had at least partially overriden the federal law imposed on them by the Depository Institutions Deregulation and Monetary Control Act of 1980. Among these twelve states, however, usury ceilings on business and agricultural loans either were unspecified or fixed at levels where they had no effect on credit flows.

Those states that were most restricted by usury ceilings generally did not act to override the preemption. In fact, many states have moved to relax their regulation of interest rates following the passage of the Deregulation Act. Those states that have not relaxed or were slow to relax their usury ceilings, particularly ceiling on consumer loans, frequently have suffered certain costs, as financial institutions increasingly have shifted some lending operations to other states that have no usury constraints.

The Board believes that interest rates are best determined in markets unconstrained by arbitrary rate ceilings of any kind. In the past, we have considered a variable rate ceiling as a preferable alternative to fixed-rate state usury ceilings. However, the Board has viewed the use of the Federal Reserve discount rate as an index inappropriate for a variable interest rate ceiling at either the federal or state level. Thus, the current bill is to be commended for not tying a federal variable ceiling to the discount rate.

To summarize, the Board continues to believe that state action rather than federal law should prevail whenever possible in dealing with the problem of fixed-rate usury ceilings. Many states have acted since 1980 to reduce the constraining effect of their usury ceilings on credit availability, and financial conditions have eased recently to the point where usury ceilings generally are not now a binding constraint. Although these factors weaken the current urgency of the matter, they do not eliminate the underlying need for further action to relax interest rate ceilings. If the Congress determines that this should be done through Federal preemption, the

Board would urge, first, that the states continue to be permitted whatever degree of override their circumstances seem to dictate and, second, that the Federal Reserve discount rate not be used in any variable ceiling rate scheme.

The CHAIRMAN. Mr. Conover.

C. TODD CONOVER, COMPTROLLER OF THE CURRENCY

Mr. CONOVER. Mr. Chairman, I have a longer statement for the record. I would like to just make a few brief remarks.

I am pleased to present my views on S. 730, which provides for a permanent Federal preemption of State usury ceilings. I strongly support this legislation. Interest rate ceilings distort the workings of the marketplace and can cause substantial damage to our economy.

First of all, interest rate restrictions do not achieve their desired objectives. The most commonly cited objective is to make adequate amounts of credit available at low rates of interest, especially to weaker borrowers and regardless of economic conditions.

Another frequently cited objective is the promotion of economic activity by keeping interest rates low. Instead of aiding weaker borrowers and lower economies, however, usury ceilings simply result in reduced credit availability and diminished economic activity.

In today's credit markets, advanced technology makes it easy for institutions to shift funds out of less profitable activities and into more profitable ones outside their local markets. Thus, lenders can and do circumvent usury limits whenever market rates exceed those limits.

Moreover, local economic growth in States with usury laws suffers when national market rates exceed usury ceilings. In such circumstances both in-State and out-of-State lenders reduce or eliminate their lending within those States.

The result is that State economic activity may be adversely affected and local unemployment may increase. The most effective means to insure wide credit availability at affordable rates is the promotion of a strong competitive financial system coupled with sound monetary and fiscal policies.

We must continue to encourage competition in the financial marketplace by expanding the product powers of depository institutions and removing geographic restrictions. Widespread credit availability depends on a flexible and responsive credit industry rather than one that is constrained by interest rate controls.

Because of the clearly detrimental effects of usury limits and the growing integration of our national credit markets, we strongly support Federal preemption of State interest rate ceilings as proposed in S. 730.

We are opposed to the creation of an alternative Federal usury ceiling indexed to the Federal Reserve discount rate. We agree with the Board of Governors that such indexing is inappropriate in light of the role that the discount rate plays in the conduct of monetary policy.

Moreover, the impostion of any ceiling ignores the fact that when interest rate ceilings are binding they distort credit allocations and when they are not binding they serve no purpose.

The bill's provision that would enable States to override the Federal preemption within 3 years represents an equitable balancing of State and Federal interests, but a State that elects to override takes the risk of reducing credit availability within its borders during periods of high interest rates, thus damaging its economy and increasing unemployment.

It is encouraging to note, however, that the majority of those States that overrode the 1980 Act's preemption either completely removed ceilings or provided for indexed ceilings or fixed ceilings at rates that are unlikely to be binding. These actions reflect recognition of the damage that usury ceilings can cause.

That concludes my remarks, Mr. Chairman.

[The complete statement follows:]

PREPARED STATEMENT OF C. T. CONOVER, COMPTROLLER OF THE CURRENCY

I am pleased to present my views on S. 730, which provides for a permanent federal preemption of state usury ceilings. I strongly support this legislation. Interest rate ceilings distort the workings of the marketplace and can cause substantial damage to our economy.

The Depository Institutions Deregulation and Monetary Control Act of 1980 contained a temporary provision that preempted state usury ceilings on business and agricultural loans exceeding $1,000 by authorizing lenders to charge up to five percentage points over the Federal Reserve discount rate. That provision expired last month. During the three-year period the provision was in effect, states had the opportunity to override the preemption.

As proposed, S. 730 would permanently preempt state usury ceilings on business, agricultural, and consumer loans. States would again be given a three-year period in which to override the federal preemption. There would be no loan-size requirement nor would there be an indexed federal ceiling.

Today I will outline why interest rate ceilings do not achieve their desired results and may even be counterproductive. I will then briefly describe several examples that support these conclusions.

THE FAILURE OF INTEREST RATE CEILINGS

Interest rate restrictions do not achieve their desired objectives. The most commonly cited objective is to make adequate amounts of credit available at low rates of interest, especially to weaker borrowers, regardless of economic conditions. Another frequently cited objective is the promotion of economic activity by keeping interest rates low.

Instead of aiding weaker borrowers and local economies, however, usury ceiling simply result in reduced credit availability and diminished economic activity. In today's credit markets, advanced technology makes it easy for any institution to shift funds out of less profitable activities into more profitable ones outside their local markets. And in the long run, they can even move their lending offices outside the rate-controlled areas. Thus, lenders can and do circumvent usury limits whenever market rates exceed those limits.

Weaker borrowers are among the first to be adversely affected by usury limits. Because the interest rate charged on a loan includes a premium that varies with the perceived riskiness of the borrower, lenders in rate-controlled areas simply avoid high-risk customers. This is done by imposing loan conditions such as large down payments, short repayment periods, a larger minimum loan size, or more stringent credit standards. The result is that credit is cut off to most weaker or lower-income borrowers.

Moreover, local economic growth in states with usury laws suffers when national market rates exceed usury ceilings. In such circumstances, both in-state and out-of-state lenders reduce or eliminate their lending within those states. The result is that state economic activity may be adversely affected and local unemployment may increase as the credit needs of consumers and local businesses are not met.

THE EVIDENCE

The failure of interest rate controls has been documented in numerous examples. In a 1977 study of the Twin Cities mortgage market, the Federal Reserve Bank of Minneapolis looked at mortgage loans when market interest rates climbed above the Minnesota usury ceiling. The result: home-purchase financing shifted from conventional mortgages, which were subject to the usury ceiling, to FHA-VA insured mortgages, which were exempted from the ceiling.

A 1976 study by the New York State Banking Department found that when mortgage lenders in New York were constrained by a below-market usury ceiling, they obtained market rates of return by making out-of-state loans. Between 1966 and 1974, when national mortgage rates were generally above the New York ceiling, the amount of out-of-state mortgages held by New York mutual savings banks averaged 48 percent of the total mortgages held. Out-of-state mortgages held by state-chartered savings and loan associations went from 7 percent to 18 percent of mortgages held.

A 1977 study documents the depressing effect of a 10 percent usury ceiling on Tennessee's economy in the mid-1970s. The study found that the state's economy grew at a faster rate than the national economy except when the usury ceiling was binding, at which time growth slowed substantially. The study estimates average annual losses of $150 million in output, $80 million in retail sales, and 7,000 jobs for the years 1974 to 1976.

A 1981 study compared urban consumer credit markets in Arkansas, which were subject to a 10 percent usury ceiling, with similar markets in states with less restrictive ceilings. It concluded that the Arkansas usury ceiling resulted in credit terms that were less favorable to borrowers. In particular, the study found that Arkansas consumers obtained relatively less bank credit and more point-of-sale credit provided by retail merchants, who compensated for the reduced profitability of their credit operations by raising prices on the goods they sold. The study also found that Arkansas lenders charged higher fees for mortgage credit evaluations and for appraisals.

More recently, we have witnessed banks shifting their operations from states with usury ceilings to those with no ceilings. The most famous of such moves was Citicorp's establishment of a credit-card bank in South Dakota.

The evience clearly shows that statutory limits on interest rates are ineffective and counterproductive. Both borrowers and local economies can be adversely affected by attempts to control loan interest rates.

The most effective means to ensure wide credit availability at affordable rates is the promotion of a strong, competitive financial system and sound national monetary and fiscal policies. We must continue to encourage competition in the financial marketplace by expanding the product powers of depository institutions and removing geographic restrictions. Widespread credit availability depends on a flexible and responsive credit industry rather than one that is constrained by interest rate controls. Similarly, continued reduction of inflationary pressures will bring overall interest rates down.

SUMMARY OF OCC POSITION

Because of the clearly detrimental effects of usury limits and the growing integration of our national credit markets, we strongly support federal preemption of state interest rate ceilings as proposed in S. 730.

We are opposed to the creation of an alternataive federal usury ceiling indexed to the Federal Reserve discount rate. We agree with the Board of Governors that such indexing is inappropriate in light of the role the discount rate plays in the conduct of monetary policy. Moreover, the imposition of any indexed ceiling ignores the fact that when interest rate ceilings are binding, they distort market allocation of credit, and when they are not binding, they serve no useful purpose.

The bill's provision that would enable states to override the federal preemption within three years represents an equitable balancing of state and federal interests. If a state wants to take the risk of reducing credit availability within its borders during periods of high interest rates, thus damaging its economy and increasing unemployment, it ought to be free to do so. It is encouraging to note, however, that the majority of those states that overrode the 1980 Act's preemption either completely removed ceilings, provided for indexed ceilings, or fixed ceilings at rates that are unlikely to be binding. These actions reflect the growing recognition of the damage that usury ceilings can cause.

Mr. Chairman, that concludes my prepared statement. I will be happy to answer any questions.

THE CHAIRMAN. Thank you.
Chairman Pratt.

RICHARD T. PRATT, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. PRATT. Thank you, Mr. Chairman, Senator Proxmire, Senator Hecht.

I have a fairly short complete statement, which I will not read. This, I believe, will be one of my shortest statements.

I would simply say that we support the bill, and would perhaps make two or three points based on the experience of our agency and my personal observations in this regard.

First, I think this is a very important piece of consumer legislation. One of the more important consumer problems we have had in the past has been the existence of usury laws. In many ways I think they work much like redlining, to preclude the individuals who may most need credit and most need access to our credit system from having an opportunity to participate in the system, to get capital and to better themselves in the markets.

So, first, I support this as a very strong piece of consumer legislation, one that shows a great understanding of the system and one which is badly needed.

Second, referring to our own experience with thrift institutions in this country, binding usury ceilings seem to be areas of concentrated problems for the financial institutions we regulate. The fact that these institutions have gotten into severe difficulty and have been able to serve their communities less ably than they would have had these usury ceilings not existed is indicative of the harm that usury ceilings inflict, not only to the financial institutions which operate in that area but also to the consumer.

Third, it seems to me that money is so fungible that we are talking about something very close to interstate commerce. And while I understand the need for State overrides and the respect which this committee and our Government have for States' rights, it seems to me that the fungibility of the commodity makes preemption of usury ceilings very similar to not having tariffs between States or having different currencies between States.

The leadership demonstrated by the Senate, in providing legislation of this type, will hopefully have a major impact on the States' recognition of the unfairness and lack of productivity associated with usury laws.

We support the bill fully and think it is a very substantial and helpful piece of legislation.

[The complete statement follows:]

PREPARED STATEMENT OF RICHARD T. PRATT, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. Chairman, Members of the Committee, I am pleased to appear before you today to testify on behalf of the Federal Home Loan Bank Board to present our views on S. 730 which provides for Federal preemption of State interest rate ceilings pertaining to business, agricultural and consumer loans.

The Bank Board fully supports preemption of State usury ceilings on consumer, business and agricultural credit transactions.

In our view, S. 730 is a well drafted bill, providing for an appropriate Federal override of restrictive State usury ceilings. The bill, however, recognizes State interest in the area by allowing for State reimposition of usury ceilings if appropriate legislative action is taken within three years of enactment of S. 730. The bill also preserves state laws enacted since 1980 imposing State usury ceilings on business and agricultural loans.

OVERVIEW

The Bank Board's opposition to usury ceilings is founded on the belief that, paradoxically, restrictive usury ceilings are not in the best interests of those whom they are designed to protect, i.e., the consumers of credit or borrowers. Usury ceilings adversely affect borrowers in a number of ways. The most dramatic effect is to stop the flow of credit altogether. This occurs when a usury ceiling is below the market rate that a lender would have to charge for a particular type of loan in order to cover its cost of funds and profit margin. In that situation a creditworthy borrower with a demand for funds and the ability and willingness to pay a market rate can not obtain a loan even though lenders may have an ample supply of funds and may be desirous of making such loans.

Not only is the flow of credit shifted, artificially, away from certain types of loans, it is also shifted geographically. Under present law, thrift institutions can make loans anywhere in the country. Therefore the proper economic decision for a lender, in a restrictive usury state, is to seek markets outside of that state. For example, in reaction to a low usury ceiling on business and agricultural loans in Arkansas, lenders will go to Mississippi or Louisiana, or even farther away, to Florida or California to make commercial loans which more accurately reflect market realities. The unintended byproduct of these so-called protective devices is a distortion of the normal flow of credit and an increase in lender's costs caused by the establishment of loan production offices in other states, including the substantial costs involved in becoming familiar with markets outside a lender's more customary lending area. These increased costs are ultimately borne by the consumer and the lender. But most importantly these are unnecessary costs; they are costs of getting around artificial legal barriers affecting the marketplace.

Of course other well publicized examples of reactions to restrictive usury ceilings have been the Citicorp move of its credit card operation to South Dakota and Delaware's "open-arm" policy toward lenders. This type of lender relocation is a direct result of artificial non-economic barriers to the distribution of credit in the marketplace.

In addition, usury ceilings disturb the flow of information to borrowers, by misrepresenting the true costs of credit in affected areas. Fair market value is something described as that price which a buyer is willing to pay, and a seller is willing to accept, both parties being under no compulsion to act and both possessing complete knowledge of all aspects of the contract involved. If this general concept of fairness is accepted, it follows that increased borrower sophistication, greater competition among lenders, and legislative safeguards such as the Truth-In-Lending Act provide more appropriate means of protection against unfairly high loan rates, without the market distortions which usury ceilings create.

SPECIFIC PROVISIONS OF S. 730

With this as background, I would like to turn now to S. 730, particularly Section 2. We support the bill's provisions concerning extension of argricultural and business credit. We endorse extending preemption to loans involving more than $1,000. In addition, we support elimination of the federal ceiling on the interest that may be charged on agricultural and business loans. We are pleased that the bill defines "agricultural credit" and "business credit," thereby providing helpful guidance as to the applicability of Section 2 to various transactions.

Looking at Section 3, we fully support operative section 531, which provides the state usury ceiling shall not apply to an "extension of consumer credit" made by a "creditor." Moreover, we support the definitions set forth in section 532. We believe that these definitions will provide desirable guidance and certainty to both lenders and borrowers concerning the scope and applicability of the preemption. We are particularly pleased that the definition of "creditor" includes persons who make mortgage credit extensions, and therefore presumably includes all thrift institutions. In addition, we read the sentence that excludes from the definition of creditors persons that have not complied with State licensing requirements as clearly inapplicable to Federally chartered associations in that they are not subject to state licensing requirements. Nevertheless, we would prefer language in the bill or its legislative history clarifying that the provision applies only to state chartered creditors or lenders that are otherwise subject to state law. This would prevent any confusion as to whether Federal associations must comply with state licensing requirements. We note that the definition of the term "extension of consumer credit" is broadly defined to include credit extended for personal, family, or household purposes. We are pleased that this definition would clearly encompass second mortgage loans, a major form of consumer credit extended by thrift institutions.

In addition, it may be appropriate to clarify an ambiguity concerning the maximum allowable rate under section 511 of the DIDMCA pertaining to business and agricultural loans. You may recall that the section in question provided for an interest rate ceiling not in excess of 5 per cent of the discount rate on ninety-day commercial paper in the pertinent Federal Reserve district. If the discount rate changed prior to a rate adjustment, it is uncertain whether the maximum allowable rate should be determined by the ceiling at the time of the making or at the date of adjustment. This issue will continue to exist under the new law with respect to pre-effective date loans. This could be resolved by an appropriate clarification in section 512(c).

Second, we support section 533, as amended. We believe it is reasonable for states to be allowed to reject the Federal preemption and to re-impose rate ceilings, subject to the three-year limitation for such action. We also believe that section 533(b)(2) will prove very useful in defining Congressional intent regarding when the preemption applies to "ongoing" credit relationships. Moreover, we believe that the 18-month phaseout period for open-end credit extensions is highly desirable in order to provide a creditor with time to adjust its lending activities to satisfy the reimposition of the state usury ceiling.

Third, we note that under new section 534, only the Board of Governors of the Federal Reserve System, as opposed to each Federal financial regulatory agency, would be authorized to publish interpretations regarding the scope and application of the usury preemption. We understand that single-agency authority is deemed appropriate in that interpretative authority is to be limited to significant questions concerning the coverage of the Act, and that substantial regulatory impact due to this authority is not anticipated. In our view, however, single-agency authority where there may be a need for extensive regulations requiring the exercise of technical expertise. Because this need is not present here, we believe it would be more efficient to follow the normal procedure of allowing each regulatory agency to issue regulations governing institutions subject to its supervisory authority. For example, we note that agency interpretations under existing Subpart C of Title V of Public Law 96-221 have been consistent and that multiple authority has proven no burden to the private sector or to any one agency. With respect to section 534(b), we believe that the "hold harmless" provision contained therein is a prudent measure, and would likewise support the addition of a similar provision in section 501 of the DIDMCA pertaining to loans secured on residential real property.

Concerning Section 4, we fully support removing the federal limitation on interest rates that may be charged by federally-chartered credit unions. Such removal is consistent with our belief that usury ceilings frustrate public policy, regardless of whether such ceilings derive from federal law or from state law.

CONCLUSION

Historically, one of the keys to our national prosperity has been that Congress has used its constitutional powers to ensure that we have a freely-functioning national economy. S&Ls tap capital markets all over the United States and may make investments across state boundaries. Congress should not be reluctant to use what authority it possesses to ensure that this national marketplace for business, agricultural and consumer credit is accessible to all our citizens without the hindrance of anachronistic local restrictions.

In sum, we support broad preemption of state usury ceilings on consumer, agricultural, and business credit. Because we believe S. 730 provides an excellent, well-drafted vehicle to accomplish this end, we fully endorse that bill. This concludes my statement. I would be pleased to answer any questions you may have.

The CHAIRMAN. Thank you.

Chairman Callahan.

EDGAR F. CALLAHAN, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION BOARD

Mr. CALLAHAN. Mr. Chairman, members of the committee, I am pleased to be here today to present my views on S. 730, the Credit Deregulation and Availability Act of 1983.

I fully support it, Mr. Chairman, and I agree with you and the other authors of this legislation that usury ceilings are no longer serving the purpose for which they were intended.

As I indicated in my testimony, on similar provisions before this committee on October 30, 1981, the ceilings cause serious problems when they are actually subjected to market rates. The problem occurs when unforeseen inflationary forces move the market rates into contact with the ceilings. A new ceiling must be established where serious problems occur.

These problems consist of distortions to business patterns and a form of credit rationing, where the least qualified borrowers are squeezed out of the market and forced to borrow from sources not subject to restrictive rates.

In 1979–80, we saw such a distortion caused by the then 12-percent Federal ceiling on credit unions. For many years, this ceiling served to signify that credit unions were member-owned cooperatives where loans could be obtained at reasonable rates. When inflationary market forces caused the credit union cost of funds to rise to the point whereby credit union earnings were actually hampered by the ceiling, credit union operations suffered in a needless fashion.

For example, prior to 1979 credit union lending had been growing at an annual rate in excess of 20 percent. In 1979, with a binding 12-percent ceiling, lending activity plummeted to a meager 3.1-percent growth. In 1980 the situation worsened and credit union loans outstanding were actually reduced.

NCUA concluded that the 12-percent ceiling was directly responsible for a reduction of $870 million in credit union lending in 1979 and 1980.

Of course, Mr. Chairman, the disruptions to credit unions were not limited to their lending activities. Federal credit union asset growth fell sharply from 17 percent in 1978 to 5 percent in 1979, and, finally, credit union earnings fell so sharply in 1979 that NCUA deemed it necessary to waive the required transferred reserves so that reasonable dividends might be declared.

Quite simply, when the return on loans is insufficient to cover the cost of funds, credit unions will always encounter serious problems.

In March 1980, credit unions were given some relief by Public Law 96–221. This raised the ceiling to 15 percent and further provided that the NCUA Board could, under certain circumstances, further raise their ceiling if necessary for periods up to 18 months.

While this present system has worked so far, credit union managers have communicated their concern to me as to what might occur if the NCUA Board was unable to act. Political pressures or other circumstances, for example, might cause a situation where this board or a subsequent board could find it difficult to act promptly.

While I am confident that the present board will meet its obligations, I am certainly sympathetic to their concerns.

Further, I believe that the lending rate is a credit union business decision, and it never should have been delegated to the NCUA Board in the first place.

Therefore, Mr. Chairman, I strongly urge that this committee adopt this amendment to the Federal Credit Union Act at the earliest possible time.

This concludes my testimony. I will be glad to answer any questions you or the members of this committee might have.

[The complete statement follows:]

Prepared Statment of Edgar F. Callahan, Chairman, National Credit Union Administration Board

Mr. Chairman, members of the Committee, I am pleased to be here today to present my views on S. 730 the "Credit Deregulation and Availability Act of 1983." This bill would, upon enactment, eliminate all state loan rate ceilings not only on business and agricultural loans but on consumer loans as well. However, the states would be given the right to reject the pre-emption within a three year period after enactment. In addition, the bill would amend the Federal Credit Union Act to provide that loan rates be determined by the individual credit union boards of directors.

I am fully supportive of these provisions, Mr. Chairman, and I agree with you and the other authors of this legislation that usury ceilings are no longer serving the purpose for which they were intended. As I indicated in my testimony on similar provisions before this committee on October 30, 1981, these ceilings cause serious problems when they are actually subjected to market rates. This is a problem which was certainly unintended by the originators of the concept of these ceilings.

The ceilings, in fact, were established to prevent the practice of "loan sharking" or charging a rate well above the market rate to an unsuspecting or uninformed borrower. They were not established as controls on the market rates themselves. What has taken place during most of the years since these ceilings were enacted is that competition continued to establish the market rate and in general it remained below the usury ceilings. Perhaps, in the final analysis, a usury ceiling lent its blessing to the free market activity which went on beneath it.

The problem occurs when unforeseen inflationary forces move market rates into contact with the ceilings. A new ceiling must be established or serious problems occur. These problems consist of distortions to business patterns and a form of credit rationing where the least qualified borrowers are squeezed out of the market and forced to borrow from sources not subject to restrictive rates.

In 1979-80 we saw such a distortion caused by the then 12 percent Federal ceiling on credit unions. For many years this ceiling served to signify that credit unions were member-owned cooperatives where loans could be obtained at reasonable rates. When inflationary market forces caused the credit union cost of funds to rise to the point whereby credit union earnings were actually hampered by the ceiling, credit union operations suffered in a needless fashion.

For example, prior to 1979, credit union lending had been growing at an annual rate in excess of 20 percent. In 1979 with a binding 12 percent ceiling, lending activity plummeted to a meager 3.1 percent growth. In 1980 the situation worsened and credit union loans outstanding were actually reduced. NCUA concluded that the 12 percent ceiling was directly responsible for a reduction of $870 million in credit union lending in 1979 and 1980.

Of course, Mr. Chairman, the disruptions to credit unions were not limited to just their lending activities, Federal credit union asset growth fell sharply from 17 percent in 1978 to five percent in 1979. And finally, credit union earnings fell so sharply in 1979 that NCUA deemed it necessary to waive the required transfer to reserves so that reasonable dividends might be declared. Quite simply, when the return on loans is insufficient to cover the cost of funds—credit unions will always encounter serious problems.

In March of 1980, credit unions were given some relief by Public Law 96-221. This raised the ceiling to 15 percent and further provided that the NCUA Board could, under certain circumstances, further raise this ceiling if necessary for periods up to 18 months. Within nine months the Board found that credit union operations were being adversely impacted by the 15 percent ceiling and it acted to raise it to 21 percent. The Board again met on March 10, 1982, and agreed to continue the 21 percent for an additional 18 months. When deliberating this ceiling, the Board must take into consideration certain important factors. First, its action should not have a curtailing effect on any credit union lending operation including, for example, credit cards. Second, credit union managers must not be forced to defer any of their business plans while "waiting" for the next NCUA Board action. While this present system has worked so far, credit union managers have communicated their concern to me as to what might occur if the NCUA Board was unable to act. Political pressures or other circumstances, for example, might cause a situation where this Board or a subsequent Board could find it difficult to act promptly.

While I am confident that the present Board will meet its obligations, I am certainly sympathetic to their concerns. Further, I believe that the lending rate is a credit union business decision and it never should have been delegated to the NCUA Board in the first place.

Therefore, Mr. Chairman, I strongly urge the Committee to adopt the amendment to the Federal Credit Union Act at the earliest possible time.

Of a technical nature, I would suggest as I did last time, that the report language on this amendment ensure that the subsequent establishment of a ceiling by a Federal credit union board of directors has the force and effect of a Federally authorized rate *and* that other provisons of the Federal Credit Union Act relating to interest rates such as late charges. Prepayment penalties, and other credit activities of Federal credit unions are not affected.

This concludes my testimony. I will be glad to answer any questions which you or the members of this Committee might have.

The CHAIRMAN. Mr. Silverberg.

STANLEY C. SILVERBERG, DIRECTOR, DIVISION OF RESEARCH AND STRATEGIC PLANNING, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. SILVERBERG. Mr. Chairman, I have a brief statement which I would like to summarize.

I am pleased to have an opportunity to testify on S. 730.

The Monetary Control Act of 1980 preempted State usury limits on residential first mortgages and established minimum ceilings on certain agricultural and business credits for a 3-year period which ended March 31, 1983.

With respect to both of these provisions, States were given 3 years during which they could override the Federal preemption.

S. 730 would eliminate interest rate ceilings altogether on the same covered areas of agricultural and business credit and eliminate rate ceilings on consumer credit.

Any State action previously taken to override the 1980 act would continue to be in force, and an additional 3-year period for possible for State override would be included.

The FDIC endorses S. 730. We believe that usury ceilings are an impediment to market behavior and that these ceilings adversely affect all sectors of the economy.

The best assurance that potential borrowers have access to credit on terms consistent with prevailing financial conditions comes from the maintenance of competitive markets. Usury ceilings actually reduce competition. They tend to injure the very people they are intended to aid by denying them access to credit.

During the last few years, Congress has taken important steps to increase competition in financial markets. Thrift lending powers have been substantially increased. Many States have responded to Federal action by liberalizing lending options for State-chartered institutions.

Interest rate ceilings have been substantially liberalized. While some restrictions remain, depository institutions probably will be completely deregulated with respect to what they can pay for funds very soon.

Deregulation has resulted in market situations where outside competitors can easily penetrate local markets wherever institutions pay significantly less than prevailing market rates.

If community banks and thrifts are to be viable competitors in the marketplace, they will have to be able to earn market rates on consumer, business, and agricultural loans. If they can't, they won't be able to pay market rates for deposits. Deposits will shift to depository and other financial institutions in other parts of the country that do pay higher rates.

As a result, ceilings will adversely affect local institutions, limit local borrowing options and adversely affect those that ceilings are supposed to protect.

Credit markets have become increasingly national in scope. We believe the Federal Government should continue to play a role in trying to eliminate usury ceilings, and we support S. 730.

[The complete statement follows:]

PREPARED STATEMENT OF STANLEY C. SILVERBERG, DIRECTOR OF RESEARCH AND STRATEGIC PLANNING, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. Chairman; I am pleased to have the opportunity to testify on S. 730, a bill to amend the Depository Institutions Deregulation and Monetary Control Act of 1980. The latter bill, among other provisions, preempted state usury limits on residential first mortgages and established minimum ceilings on certain agricultural and business credits for a three-year period which ended March 31, 1983. With respect to both of these provisions states were given three years during which they could override the Federal preemption.

S. 730 would eliminate interest rate ceilings altogether on the same covered areas of agricultural and business credit and eliminate rate ceilings on consumer credit. Ceilings would also be removed on all loans of Federal credit unions. S. 730 would permit states to override the Federal statute during a three-year period following its enactment and, in addition, any state action previously taken to override the 1980 Act would continue to be in force. If S. 730 is enacted, it could, for all practical purposes, eliminate usury ceilings altogether in states that have not overridden provisions of the 1980 Act and choose not to override S. 730.

The FDIC endorses S. 730. We believe that usury ceilings are an impediment to market behavior and that these ceilings adversely affect all sectors of the economy. The case against usury ceilings has been well documented in theoretical and empirical studies. Those parties most directly impacted by ceilings in those states with the most restrictive ceilings have been among the strongest advocates of revision, providing practical evidence of the perverse nature of restrictive ceilings.

A recent study of the impact of the ceiling on consumers in Arkansas documents how ceilings acted to reduce consumer options, to channel financing to more costly and less efficient alternatives, to raise credit standards and limit terms so that lower income consumers were rationed out of the market, and generally to affect the economy in a perverse manner. Other studies and more casual observations indicate similar and equally perserve results in other situations where usury ceilings have been very restrictive.

The Depository Deregulation and Monetary Control Act of 1980 set minimum ceilings on agricultural and business loans that were tied to the Federal Reserve discount rate. Many have testified against the appropriateness of tying ceilings to an administered short-term rate (I did in testimony on S. 1406 and S. 963 two years ago). We are please that S. 730 sets no rate-tied ceiling. While better choices exist that the discount rate, there is no assurance that a market-tied ceiling won't become overly binding at some future date. We favor the provisions of S. 730 which eliminate ceilings altogether, if states don't act to override. Also, we strongly favor the inclusion of consumer loan rates in the Bill.

The best assurance that potential borrowers have access to credit on terms consistent with risk, prevailing interest rates and the overall demand and supply of savings comes from the maintenance of competitive markets in the financial services industry. Usury ceilings actually reduce competition and the alternatives available in local credit markets. They tend to injure the very people they are intended to aid by denying them access to credit.

During the last few years Congress has taken important steps to increase competition in financial markets. Thrift powers to lend in business and consumer credit markets have been substantially increased, and many states have responded to Federal action by liberalizing lending options for state-chartered institutions. Interest rate ceilings have been substantially liberalized. While some restrictions remain (which we hope will be dismantled soon), it is not much of an exaggeration to say that depository institutions are unregulated with respect to what they can pay for funds. And that's certainly true of their competitors. This has resulted in market situations where outside competitors can easily penetrate local markets wherever institutions pay significantly less than prevailing market rates. Competition has been substantially expanded for retail deposits.

In order to earn satisfactory returns on funds that are no longer available at bargain rates, lenders are under pressure to seek out loan alternatives in their traditional trade areas or, if necessary, in other areas. Thus, fewer markets will be insulated. Competition has been increased and that increase is likely to spread. As a result, we do not see any need to protect borrowers from "excessive" rates. If community banks and thrifts are to be viable competitors in the marketplace they will have to be able to earn market rates on consumer, business and agricultural loans. If they can't, they won't be able to pay market rates for deposits. Deposits will shift to depository and other financial institutions in other parts of the country that pay higher rates. As a result ceilings will adversely affect local institutions, limit local borrowing options and adversely affect those that ceilings are supposed to protect.

We note from the financial press that recent declines in interest rates may remove pressure to abolish ceilings through Federal legislation. It is true that not as many state ceilings are below market rates today than at some times in the past. However, nobody can forecast interest rates with a great deal of confidence. Too many external forces can affect rates and, in the past, they have. We see no reason to have second thoughts about eliminating ceilings now, just because doing so is not that urgent.

We believe, and I have already suggested, that credit markets have become more and more national credits. No one would question this with respect to large corporate credits. Indeed, many foreign banks have penetrated lending markets for what used to be considered regional firms, let alone the lending market for national firms. In consumer and real estate markets there are many national participants including bank and affiliates and major nonbank financial conglomerates. We are not overly troubled by Federal preemption in this area as S. 730 does give states the option of overriding the elimination of ceilings as did the 1980 Act. We understand that about 15 states took advantage of this option in the last three years, although some merely preserved their future options without imposing ceilings.

Mr. Chairman, the FDIC supports S. 730.

The **CHAIRMAN**. Thank you very much. Gentlemen, that is truly a remarkable performance. In my 8½ years in the Senate, I have never heard five witnesses do their testimony in less than 15 minutes. [Laughter.]

It is incredible. I am impressed. We appreciate your concise testimony.

The Federal Reserve Bank of Chicago study concluded that from an economic point of view there is clear benefit from Federal preemption of usury ceilings. Uniformity enables markets to work more efficiently and removes the differentials that distort credit flows among the States.

That study also indicated that the economic benefits need to be weighed against the political implications of Federal preemption. I don't know that the Chicago Fed should be discussing the political considerations. They might confine themselves to the economic implications.

Governor Partee, you are the only one of the regulators who, while opposing credit interest rate ceilings, has reservations about Federal involvement in this area. I would like you to comment on the Chicago Fed's viewpoint that—economically speaking, uniformity is beneficial, and ask you if the Fed's objection to Federal preemption is based on economic or political considerations.

Mr. **PARTEE**. Mr. Chairman, I didn't happen to read the Chicago Fed article, so I am unable to agree or disagree with it. I agree with the economic argument for removing interest rate ceilings on the vast number in business, mortgage, and consumer credit transactions. I think the economic arguments are very strong, and have been for a long time. I very strongly favor not having usury ceilings because of their interference, which creates great difficulties, in the proper workings of those markets.

I agree with the other witnesses here, that two things make it more difficult to try to maintain the usury ceilings. First, that we have deregulated on the liability side for the depository institutions, and necessarily then, they have to be able to have the freedom to operate on the asset side.

Second, that the opportunities for jumping from one State to another, for both the extension of credit and the obtaining of credit, have grown much greater over the last several years. Thus on economic and political grounds, I would say that for the vast majority of credit, it would be better not to have the ceiling.

SMALL LOANS TO DISADVANTAGED BORROWERS

The concern that I have with preempting usury ceilings, and I believe that my associates on the Federal Reserve Board share, is in the consumer credit field. Here we're talking about small loans to disadvantaged borrowers, such as might have been made under the small loan laws or such as credit sales that are made by some furniture stores, appliance dealers, and lenders like that.

The question is, if the rate is already 50 percent, will raising it to 100 be helpful to the borrower? And I guess I would feel that economic logic tends to break down at the point where the risk of the transaction and the status of the two participants in the transaction are such that it can escalate the rates to the point where it will just get the borrower in more and more trouble. This was the reason the small loan laws that exist today were passed.

The Board does not oppose preemption as it has tended to do in past hearings. What it does suggest is that the States ought to have a chance to look particularly in those areas of consumer credit that involve small customers, small loans, and see where it would be best to override that preemption. I am sure that there would be such instances in some of the States.

The **CHAIRMAN**. I don't disagree with you on that. But any interest rate you set is a usury ceiling, therefore we look to other laws to try and protect against that situation.

Mr. Conover, in your statement, you suggest that when creditors do not make a fair rate of return from interest rate ceilings, they compensate by imposing more stringent noninterest provisions on their lending and by increasing noninterest costs such as the price of the goods or the services.

This occurs even though the explicit cost of credit, the interest rate, is lower due to the ceiling.

Is the total overall cost to the borrower often the same as if you had not had an interest rate ceiling if you add in those other costs?

Mr. **CONOVER**. It could be the same, or it could be higher. If the usury ceiling were removed, I think credit availability would be increased, and the dependence on those other pricing mechanisms would decline.

The **CHAIRMAN**. Don't these noninterest conditions and costs tend to really allow the lender to hide the total cost of the transaction?

Mr. **CONOVER**. Yes; they do.

The **Chairman**. That's why I have a little difficulty in understanding the great benefit of interest rate ceilings.

I continue to talk about interest rate ceilings. I've been talking about them for so long in relation to regulation Q, now I have a hard time making the transition to discussing them in the context of usury.

But it seems to me that once again, as I said to Secretary Sprinkel, they encourage higher cost transactions. They push the lower income segment, over and over again, to those types of transactions that hurt the very people that the ceilings are intended to help.

There are so many examples of the unsophisticated borrower getting driven someplace where there are more added costs, and they are being hoodwinked deliberately. This is a result of not being able to charge market rates in the basic interest rates, and be up front about it.

Mr. **Conover**. I would agree with that. If the lender cannot get the market rate through one means—if he chooses to lend at all, which he may not—he may very well try to increase his profitability by other means, such as these other ways of increasing the price of credit.

The **Chairman**. Senator Proxmire?

Senator **Proxmire**. Governor Partee, I don't know if I put it properly: When you say you seem to be the lone holdout against this legislation, you're sort of a mild holdout at the same time.

You've lost the FDIC as an ally from your position in the past 2 years. Obviously, you don't think the arguments in favor of the bill are so powerful as to override the provisions.

I wonder if you could expand on your view that nothing has happened over the past few years that would mandate Federal preemption of State statutes?

Mr. **Partee**. A lot has happened over the last few years, Senator.

MANDATE FEDERAL PREEMPTIVE LEGISLATION

Senator **Proxmire**. But nothing that would mandate Federal preemptive legislation?

Mr. **Partee**. Mandating Federal preemption of usury ceilings of all kinds seems to be a very strong action to take. We've looked at the consumer loan laws of some States and found usury implications in many, many aspects of State law. In the case of Massachusetts, as I recall, there are more than a dozen laws that each have numerous provisions addressing some aspect of usury ceilings or rate ceilings. To preempt these provisions of State law without knowing what the impact of that will be on the State, seems to me to be a very strong step to take. For this reason, we continue to have reservations.

I might add that the bill before you calls upon us to distinguish between rate laws that would be preempted and consumer credit protections that would not be preempted. We're concerned and apprehensive about what that might mean due to the complexity of State laws.

Senator **Proxmire**. You've, obviously, looked at this, and you cite Massachusetts as an example.

Is there any way we can get a comprehensive notion of what these State laws are that you feel might be offended by this action?

Mr. **Partee**. No, sir, we haven't been able to do that. It's a very laborious job, and would require legal research of some depth into each State's situation. Sometimes the situation differs greatly among States. Louisiana, which has a different legal background than other States of the union, for example, requires almost a different mentality of lawyer to look at the provisions.

So, we haven't been able to do it and we're not sure what the problems will be in trying to distinguish between consumer credit protections and usury ceilings or rate laws.

What I do mean to say, Senator, is that our view now is that perhaps in this case an override provision, rather than a total preemption, is warranted.

Senator **Proxmire**. I understand that the law, that expires, and you object to that provision. I'm not sure whether we can put it in at this part of the bill or not, tying agricultural credit to 5-percentage points above the discount rate.

You object to that.

Mr. **Partee**. We've always objected to tying the ceiling to the discount rate.

Senator **Proxmire**. What Government rate would be better?

Mr. **Partee**. I would think a short-term market rate.

Senator **Proxmire**. The short-term market rates?

Mr. **Partee**. The 6-month Treasury bill. The reason is that at times, we have need to move the discount rate in a way that may not be reflecting of the market.

Senator **Proxmire**. Do you think that the State usury ceilings help, restraining the economy in times when that's appropriate monetary policy?

I asked that same question of Mr. Sprinkel, but he's a monetarist, and he gave me the kind of an answer I'd expect. You're a little more eclectic, and I'd like to hear your explanation.

Mr. **Partee**. Yes, I heard the exchange, Senator. I don't believe that usury ceilings are very important considerations in this case. The argument usually has to do with whether various nonprice rationing provisions which might be much broader than usury ceilings would help to restrict the credit flow, and thereby, the supply of money and credit. I would say there is a credit rationing effect that can restrict the growth of money and credit, but the issue that we have before us today is so minor quantitatively that I don't think it's an important consideration in that argument.

CONSUMER LOAN RATES VERSUS BUSINESS LOAN RATES

Senator **Proxmire**. Do you feel there's a difference between consumer loan rates and business loan rates? The reason I ask that is because, as Mr. Schechter, who is going to testify later, points out, about a month ago, Assistant Secretary of the Treasury Manuel Johnson testified before a subcommittee of this committee and said, "Consumer loan rates are generally considered to be administered rates, rather than competitive."

The reason was the restrictive market in which the consumer borrower shops for credit, generally in his immediate neighborhood or town, and perhaps only at his institution of deposit.

Furthermore, large banks like Citibank, with 220 branches in New York City are a large local market influence.

He argues that lenders don't have to respond quickly on consumer rates to market forces, and of course, when you're lending to business, it's much more competitive, and we can respond more quickly.

If that's the case, is it possible that this legislation might put the consumer at a disadvantage, because these are administered rates?

They'd be more likely to administer them at a level that would be profitable for the lender, and therefore higher and unfair to the borrower.

Mr. PARTEE. There is a degree of administration, no doubt, in the consumer lending area. As a Virginia resident, I have recently been receiving notices from the department stores that they will be raising their rates to 21.6 percent beginning in April. And there's no economic or marketplace justification whatsoever for that. It simply reflects an increase in the usury ceiling permitted in the State of Virginia.

So, I can understand Henry Schechter's point of view on this. I would say, though, that market competition is growing all the time in the major consumer lending markets. Hardly a week goes by but that I, and I'm sure you, don't receive offers of credit from other States, usually involving large amounts of money rather than low interest rates. But also, increasingly, competition is bringing lower rates to bear as lenders have funds to put to work. So that it's a mixed bag, I believe, Senator.

I would say that time is increasing competition. Time and conditions, and that this will reduce the degree of administration in the rate structure.

But there still is——

Senator PROXMIRE. That doesn't bother you very much at the present time? Things are moving in the right direction. It's sufficiently competitive now so that we don't need usury limits.

Mr. PARTEE. I certainly wouldn't attempt to use those department store credit lines.

Senator PROXMIRE. Mr. Conover, there's been a great deal of reliance on the part of Mr. Sprinkel and others, and I think the bill itself relies on competition in the marketplace.

I just wonder how really effective that is? Some States have strict entry, for example, into the finance company business. Thereby curbing competition.

If the Federal Government repeals all usury ceilings, do you think we should see if we could take some kind of an action preventing that kind of limitation on entry by finance companies?

Mr. CONOVER. As I think you know, Senator, I am a strong advocate of increased competition among all types of financial institutions, and I advocate the breaking down of geographic barriers that would prevent increased competition from happening.

So, I think anything we could do in preventing restricted entry would be good for the public.

Senator PROXMIRE. So, you'd support Federal preemption legislation in that area?

Mr. CONOVER. Well, at that point, you are getting into issues involving what could be called the dual banking system. The question is whether or not we ought to continue to have State-chartered financial institutions of one particular category or another.

So, I do not think I am prepared to say that we ought to have entry restrictions.

Senator PROXMIRE. You see the dilemma that puts us in.

Mr. CONOVER. Yes; I do.

Senator PROXMIRE. On the one hand, we can keep up competition by finance competition. On the other hand, we take off the usury ceilings and protect the consumer against the limited competition.

Mr. CONOVER. On the other hand, there are many different types of institutions that offer these kinds of services, that are not restricted, that do not have restricted entry as a State finance company might.

Additionally, I think we are seeing more and more competition across State lines in the lending area, as we have seen recently in the deposit area.

Senator PROXMIRE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hawkins.

Senator HAWKINS. Mr. Conover, or whoever on the panel can answer this, can you give me examples where States have lifted the usury rate and consumer interest rate went down?

Mr. CONOVER. I cannot give you any examples of that, Senator, because I do not believe that the market interest rate is affected by the existence of a usury ceiling at all.

I think market rates are quite independent of it.

Senator HAWKINS. It puts a ceiling on it, does it not?

Mr. CONOVER. If we think in terms of two kinds of rates—there is a market that is determined by forces in the marketplace and the rate is whatever it is. If you impose a usury ceiling in a situation where the market rate exceeds the usury ceiling, the market rate itself still exists and funds will flow out of restricted areas where that usury ceiling is in effect into nonrestricted areas in order to achieve the market rate.

Mr. PRATT. Senator, I might be able to be somewhat helpful on this.

In one of my earlier incarnations as a college student, I was a bill collector for a small loan company in a State that had a usury ceiling of 36 percent for small loans. We uniformly charged the 36 percent rate.

While that law may still be in effect, to a very large extent, that 36 percent credit has been supplanted with the type of national credit cards—VISA, Master Charge, and so on—which typically charge about 18 percent. Credit costs in that area was thereby reduced rather substantially.

In the agency which we administer, we did see substantial examples of States with severe usury laws, where a major segment of the public was excluded and people were not able to obtain mortgage loans.

Whether the borrowers obtained loans at higher rates or were simply excluded from the market, I am not sure. But my guess would be that those who did find places to borrow money were paying a higher rate than after the usury ceiling was eliminated and credit flowed freely to those people.

Mr. PARTEE. As a factual response, Senator, in recent months we've had many cases where interest rates have come down in States that, at the same time, have been lifting or have already lifted usury ceilings. Car loan rates have dropped, second loan mortgage rates have dropped quite generally around the country. There are some that I don't believe have dropped, such as credit cards and department store charge cards. They have tended to go to the usury ceiling.

But we've had numerous examples of a decline in consumer rates.

Senator HAWKINS. President Reagan and other members of the administration have decried the failure of consumer interest rates to follow market rate declines. And we've seen a large spread, which we used at the hearings that we conducted—Senator Proxmire and I conducted on consumer interest rates. We've seen such a large spread between what banks pay for their money, as measured by the Federal funds, and the rates that they charge for consumer loans.

Are there any statistics available indicating the profit margin for banks in consumer lending?

Mr. CONOVER. Senator, the problem in coming up with a profit margin for a particular category of loan is that it is difficult to know what sorts of funds to select as being the source of the money that is being lent.

Since you have deposits, for example, on the liability side of the balance sheet purchased at different rates for different terms and so forth, it is difficult to say which of those sources of funds are used as the source for a consumer loan that might be at 18 percent.

So, I know of no data that indicates the relative profitability of a credit card operation or consumer loan versus commercial loans or mortgage loans.

Money being fungible, it is difficult to determine.

Senator HAWKINS. You're telling me you don't color-code the dollars?

Mr. CONOVER. Exactly.

Senator HAWKINS. Why would the banks stay in any business that they lose money on?

Mr. CONOVER. It is hoped that over the long term, banks would not continue lending if they knew they were losing money on it.

IMPACT OF FAILURE IN FOREIGN LOAN REPAYMENTS

Senator HAWKINS. That leads to another question—on foreign loans.

Do you have any feeling, in the constant headlines that we see and stories that we're reading, that one of the reasons consumer interest is staying abnormally high is to give a hedge against foreign loans that may have been given without a thoughtful process in recover?

Mr. **Conover**. I have seen those reports in the press as well. I think banks are under considerable profit pressure today from several different dimensions.

Foreign loans—or the potential for a loss on foreign loans—is one of them. Losses on domestic loans are another important reason. Finally, because of the fact that we deregulated interest ceilings on the liability side of the balance sheet, banks are having to make every effort to maintain normal interest rate spreads and to maintain their profitability. I think we expect them to do that.

So, I do not think there is any single contributor to higher consumer interest rates.

Senator **Hawkins**. We read a lot about the big banks, you know, the huge banks. But I understand that Treasury has identified nearly 400 banks in 35 States and Puerto Rico with foreign loans of at least $10 million on their books.

Does this indicate to any of you that the problem is not confined to just the big market-center bank?

Mr. **Pratt**. Senator, when one looks at the structure of consumer lending in this country, not just the insured depositories, I think we have something like 3,300 S&L's and well over 13,000 banks, and I guess about 40,000 credit unions, or whatever.

It is pretty hard to believe that a cartel exists among 40,000 separately owned and regulated institutions.

And while the foreign loans—while those banks might like to let that foreign lending affect their operations in this sense, to try and keep profit margins up, there are many, many, many institutions out there obtaining funds in the market and lending them in the market which have, of course, no connection whatsoever with foreign lending.

Senator **Hawkins**. In the 400 banks I'm speaking of, however, will that create a problem, the 400 banks that have been identified?

Mr. **Pratt**. It would seem to me that would not have much effect on the cost of consumer credit nationwide.

In our own experience, where we've had the worst 2 years in thrift history and institutions would like to have kept their profit margins up, the market was so competitive that it was not possible.

Senator **Hawkins**. If you don't color-code the money, how do you know what has gone to foreign losses and what has gone to consumer losses?

Mr. **Conover**. You can identify the losses that are attributable to foreign loans or domestic loans by category, including consumer loans. But you cannot attribute the source of funding for those loans.

Mr. **Partee**. Senator, I think the point is that relatively few—and far fewer than the 400 large banks that you mentioned—have liquidity problems with their foreign loan portfolios. And those relatively few institutions can't dominate the market.

Citicorp, for example, can't charge more to the consumer for a loan than would many other competitors, including savings and loans and the smaller banks and all that, and be able to maintain their share of the market. Therefore, the market rate will be determined by these many thousands of alternative sources of credit.

SECONDARY MARKET FOR CONSUMER LOAN PORTFOLIOS

Senator HAWKINS. Preston Martin—and you have heard or read his testimony at my Consumer Affairs Subcommittee meeting—stated that the development of a secondary market for consumer loan portfolios could make consumer rates more responsive to market rates. And he cited as a model the development of the secondary market for conventional home mortgages.

Would any members of this panel care to comment on this suggestion?

I think it's a novel idea. And I'd like to know how you would develop one.

Mr. PRATT. One comment on it. The mortgage secondary market has taken several years to develop and is partly a function of substantial standardization and large loan sizes that exist in this market.

The cost of administering the mortgage loan relative to each dollar lent is, of course, much, much less than a consumer loan. A mortgage loan is normally made once. It may stay 5 years, 10 years, or it may stay the full 30 years. In many cases, the homogeneity is greater.

I think it will be more difficult to develop a secondary market in consumer loans. If that's to be done, what we'll have to see is a standard type of contract that might well be done with units of $100 or $500 or $1000, or whatever it might be. But it would clearly require a great deal more standardization than exists at this time and a method for dealing with that paper at a relatively low cost.

You get some indication of the difference in cost when looking at, for instance, the expense ratios of a savings and loan versus a commercial bank. A savings and loan may have expenses that run 1-1½ percent of its assets, whereas a small or medium-sized commercial bank may be in the 3½ to 4 percent range.

A good deal of that difference is reflected in the smaller loans, requiring more personal attention, which the commercial bank might make.

Senator HAWKINS. Thank you.

The CHAIRMAN. Senator Hecht.

Senator HECHT. Mr. Chairman, I just think Mr. Pratt hit it right on the head when he said it's consumer legislation, because that's exactly what it is.

In the last few years, when interest rates were so high, 18, 20, 22 percent, it was the consumer that was penalized in the States that had this type of legislation.

So, I agree with exactly the way he put it.

Thank you very much.

CREDIT UNION INTEREST RATES

The CHAIRMAN. Mr. Callahan, in our hearings back in 1981, there was some testimony and colloquy between Senator Lugar and Mr. Barr about raising the consumer credit union rate ceiling from 12 to 15 percent, and you had gone to 21 percent.

There's a chart showing distribution of federally insured credit unions by most common interest rates charged in 1980.

The substance of the chart was that 60 percent of them were still charging 12 percent after it had gone to 21, which was the legal limit.

Of the 16,121 credit unions involved in the survey, only 8 had gone to 21 percent, certainly indicating that there is validity in the saying that usury ceiling often becomes the floor.

My question is simply, could you update that chart for us for the record and let us know what the current situation is?

This was the most common rate in 1980. And I'd appreciate it if we could have that information updated for us.

Mr. CALLAHAN. Senator, I'd be glad to forward that information off our most recent year-end report.

I would like to just briefly say that you would find that the average these days is far below the legal limit that's allowed by law, averaging perhaps in the 15- to 16-percent category for auto loans for example.

We will update the record for you as soon as possible.

[Information subsequently furnished for the record follows:]

HIGHEST RATES OFFERED BY FEDERAL CREDIT UNIONS ON NEW CAR LOANS END OF DECEMBER 1982

RATES	NUMBER OF OF FCU's	ASSETS	PERCENT ACTUAL
Less than 12%	145	587,919,241	1.3
12-13%	1,830	5,558,825,721	16.1
13-14%	641	4,946,816,020	5.6
14-15%	1,010	10,712,766,158	8.9
15-16%	3,855	13,526,933,347	33.8
16-17%	667	4,461,467,280	5.9
17-18%	230	1,749,220,828	2.0
18-19%	560	1,885,896,081	4.9
19-20%	22	371,457,865	0.2
20-21%	12	111,076,439	0.1
=21%	17	288,408,486	0.1
TOTAL*	11,402		

*NOTE- Includes 2,413 Federal Credit Unions (21.2%) which did not make new loans during this period.

The **CHAIRMAN**. Thank you very much.

Do you have any additional questions, Senator?

Senator **HAWKINS**. I have several headlines here that may be very familiar: "Judge Suspends S&L Takeover; When Word Came 200 Feds Swooped Down on Biscayne; U.S. Agency Takes Over Biscayne S&L," which was the first bank to fall in our State, I guess, in the history of Florida.

I watched with interest this morning someone on television—the show before the "Today Show"—I believe someone from your organization—stating that they viewed this with great speculation, because with the amount of drug money available in Florida no bank needs to fail. [Laughter.]

Senator **HAWKINS**. I take great offense at that statement.

Mr. **PRATT**. I hope it wasn't from our organization.

Senator **HAWKINS**. I'll know in another hour.

I have tried to find out who this fellow is.

And, you know, we've got an IRS man down there in the bank, color coding the money. If it's coke money, it's being identified.

This morning, saying this on television before everybody else, I'll tell you, it's had me up all morning, and it will the rest of the day.

That statement is completely irresponsible, should not have been made to his wife, let alone on television.

And what we're trying to do in Florida—and I'm heavily involved in this—as you know, we have another group ready to help and we've had regulators and the Government in between, the Kaufman group—the one taken over even last fall.

I think I discussed it with you on several occasions. It became kind of a weekly topic.

I was just surprised stockholders had done this at Biscayne S&L.

I'd like to not belabor the record here, but I'd like to find out who this man is who is running around saying this, because it really is a bad advertisement for any agency to say that, No. 1. No. 2, I'd like to talk to you more in detail about this entire matter, which has our State absolutely on end.

You know, in the morning papers, the two that you're looking at, we've tried very hard to work this out quietly and calmly so the stockholders would be protected, as well as the depositors.

I just wanted to make that comment to you in case you weren't up at 6 a.m. this morning to see that.

Mr. **PRATT**. If it was someone from our agency, I apologize in advance. And I agree that those kinds of statements should not be made.

Senator **HAWKINS**. Thank you.

The **CHAIRMAN**. Thank you very much, gentleman. We appreciate your testimony.

And we would ask the next panel to come up:

Dr. Richard Rahn, vice president and chief economist, U.S. Chamber of Commerce; Eugene Schotanus, senior vice president, Deere & Co., Moline, Ill.; and Lee Palmer, president, Hearthstone Group, Milwaukee, Wis.; on behalf of Small Business United and Independent Business Association of Wisconsin.

The **CHAIRMAN**. Gentlemen, we appreciate your willingness to be here today.

We would like to start—and if you would excuse me momentarily, to make a phone call, I will make Senator Hawkins the acting chairman. I will be right back.

STATEMENTS OF RICHARD W. RAHN, VICE PRESIDENT AND CHIEF ECONOMIST, U.S. CHAMBER OF COMMERCE; EUGENE L. SCHOTANUS, SENIOR VICE PRESIDENT, DEERE & CO.; AND LEE PALMER, PRESIDENT, HEARTHSTONE GROUP, MILWAUKEE, WIS., ON BEHALF OF SMALL BUSINESS UNITED AND INDEPENDENT BUSINESS ASSOCIATION OF WISCONSIN

Mr. **Rahn**. Thank you, Mr. Chairman. My name is Richard W. Rahn, vice president and chief economist of the Chamber of Commerce of the United States. On behalf of the chamber's more than 226,000 members, I welcome the opportunity to support S. 730, the Credit Deregulation and Availability Act of 1983.

Over 90 percent of our members are small businesses having fewer than 100 employees. The U.S. Chamber and its Small Business Council have traditionally opposed Government price controls, of which usury laws are a particular variety.

Mr. Chairman, I request that my entire statement be made part of the record. In the interest of time, I will summarize my remarks.

USURY LAWS DO NOT INCREASE AVAILABILITY OF CREDIT

Nearly every study involving States with stringent interest rate ceilings demonstrates the folly of interfering with the operation of a competitive market under the pretext of improving its performance. The evidence overwhelmingly suggets that usury laws do not increase the availability of affordable credit to low- and moderate-income individuals and small businesses.

On the contrary, preventing interest rates from rising to market-clearing levels results in reduced credit supplies in proportion to the degree of restraint imposed by the legal interest ceiling, discrimination against low- and moderate-income borrowers and small business by lenders, loss of jobs and output, and an increase in efficient business practices.

Actually, the best way to prevent exploitation of buyers in a market situation is to promote competition among sellers, especially price competition. Usury laws accomplish the exact opposite. When interest rates are held below free market levels, many lenders are driven out of the market altogether and credit supplies dry up. Arkansas' 10-percent ceiling, for instance, caused every personal loan company to leave the State when interest rates rose after 1977.

Artificially low interest rate ceilings not only decrease the supply of credit, they also increase the prevalence of nonprice credit rationing and discrimination by lenders. No fewer than eight separate studies of consumer lending under usury ceilings indicate that less creditworthy customers are denied credit more frequently than would occur in an unrestricted market.

High real or inflation-adjusted interest rates do adversely affect business.

During 1981 and 1982 both real interest rates and the number of business failures rose to abnormally high levels. Nevertheless, these high real interest rates did not result from a lack of competition among lenders in credit markets, which might be used as a justification for usury laws. On the contrary, the behavior of interest rates over the past several years can be explained in terms of the rational response of lenders and borrowers to adverse economic conditions, especially inflation, and to the Federal Reserve Board's highly erratic performance in controlling monetary growth.

There does not appear to be any way in which usury laws could have kept real borrowing costs from rising during 1981 and 1982. In fact, had the Federal Government not preempted the usury ceilings that were in effect in many States, the rate of business failures would probably have been higher than it actually was and few mortgages would have been made.

Usury ceilings are no more a cure for high interest rates than bleeding the patient is a cure for infection.

Thank you, Mr. Chairman.

[Complete statement follows:]

PREPARED STATEMENT OF DR. RICHARD W. RAHN, CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA

Mr. Chairman, my name is Richard W. Rahn. I am Vice President and Chief Economist of the Chamber of Commerce of the United States. On behalf of the Chamber's more than 226,000 members, I welcome the opportunity to support S. 730, the Credit Deregulation and Availability Act of 1983.

Over ninety percent of our members are small businesses having fewer than 100 employees. The U.S. Chamber and its Small Business Council have traditionally opposed government price controls, of which usury laws are a particular variety. S. 730 offers a comprehensive and permanent approach to the abolition of these harmful, archaic regulations.

SUMMARY

Nearly every study involving states with stringent interest rate ceilings demonstrates the folly of interfering with the operation of a competitive market under the pretext of improving its performance. The evidence overwhelmingly suggests that usury laws do not increase the availability of affordable credit to low- and moderate-income individuals and small businesses. On the contrary, preventing interest rates from rising to market-clearing levels results in:

Reduced credit supplies in proportion to the degree of restraint imposed by the legal interest ceiling.

Discrimination against low- and moderate-income borrowers and small businesses by lenders.

Loss of jobs and output and an increase in inefficient business practices.

By preempting these artificial restrictions on interest rates, the federal government would prevent the considerable damage caused by them during periods of high interest rates.

USURY LAWS REDUCE CREDIT SUPPLIES AND ENCOURAGE DISCRIMINATION

Usury laws allegedly serve two purposes: (1) They prevent lenders from exploiting borrowers by keeping borrowing costs low; and (2) They supposedly enable poor people, minorities, and small businesses to compete for available credit supplies on a more equal basis with the rich.

When it comes to protecting borrowers, however, legal interest ceilings are unnecessary as well as counterproductive. Most business people have plenty of experience in dealing with lenders and therefore do not need usury ceilings to "protect" them from lenders. Less-experienced borrowers, on the other hand, can be adequately safeguarded by "truth-in-lending" laws which require the terms of a loan to be written out in clear, comprehensible language.

Actually, the best way to prevent exploitation of buyers in a market situation is to promote competition among sellers, especially price competition. Usury laws accomplish the exact opposite. When interest rates are held below free-market levels, many lenders are driven out of the market altogether and credit supplies dry up.

Arkansas' ten percent ceiling, for instance, caused every personal loan company to leave the state when interest rates rose after 1977.

Usury ceilings on conventional mortgages within a state have been shown to reduce both the volume of mortgage credit available and the number of housing starts within that state.[1] The magnitude of this effect is not small. For each percentage point below the estimated market-cleaning rate, mortgage interest ceilings apparently reduce housing starts by sixteen to twenty-eight percent below "free-market" levels.

It is indeed fortunate that the Federal government has permanently overridden state interest ceilings on residential first mortgage loans, but we need the same kind of protection for business and agricultural borrowers. Without it, investment in business and agricultural plant and equipment will be needlessly reduced should market interest rates again rise to high levels.

Artificially-low interest ceilings not only decrease the supply of credit; they also increase the prevalence of non-price credit rationing and discrimination by lenders. No fewer than eight separate studies of consumer lending under usury ceilings indicate that less creditworthy customers are denied credit more frequently than would occur in an unrestricted market. Lenders accomplish this by raising the non-interest costs of borrowing through such devices as higher downpayments, collateral requirements, and closing costs. They also confine loans to preferred customers and friends. Borrowers who do not fall into these privileged categories are denied the only effective means they have of competing with those who do—a willingness to pay a market interest rate.

USURY LAWS AND INEFFICIENT BUSINESS PRACTICES

Restricting competition in credit markets can also lead to inefficiency and less competition in product markets. For example, when interest rates rise, commercial borrowers in states with relatively stringent interest ceilings experience difficulty obtaining credit. A large business with access to the national credit market may be able to secure credit outside the state, but smaller competitors may find this difficult to do. Thus, small firms are put at a comparative cost disadvantage that impedes their ability to compete in the state's product markets. Less competition means higher prices for those products.

Even those companies which are able to secure credit out-of-state may resort to inefficient business practices because of usury ceilings. Firms that sell credit-financed, "big ticket" items, for instance, often compensate for their customers' inability to obtain credit at the legal interest limit by offering seller financing through captive credit companies. The operations of these credit companies usually decrease the total profitability of the company's business within "problem" states, because the funds lent to customers at the legal interest limit are obtained elsewhere at substantially higher rates.

Losses on credit operations in a given region are made up by raising the cash price of the product in that area. The higher product price effectively forces cash customers to subsidize credit customers. Since some of the low-income persons who are refused credit at the legal ceiling rate will manage to make cash purchases, the subsidy runs from the poor to the rich.

THE MACROECONOMIC COSTS OF STATE USURY LAWS

Since an adequate supply of credit is necessary for trade and commerce, artificial restrictions leading to reduced credit supplies or to misallocation of available credit will have a harmful effect on an economy. The only major investigation into the macroeconomic effects of usury laws supports this distrubing conclusion. The study estimated the economic costs to the state of Tennessee during the period from 1974 to 1976 due to its comprehensive 10 percent interest rate ceiling.[2] The investigators found that the state usury law resulted in an average loss in output of $150 million per year, an average loss of 7,000 jobs per year, retail sales losses of $80 million per year, and losses to financial intermediaries of $1.25 billion per year. No wonder that Tennessee raised its usury ceiling in 1978, but totally eliminating such restrictions would reduced the risk of similar losses in the future to zero.

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[1] For a comprehensive survey of the economic effects of state usury laws, see Harold C. Nathan, "Economic Analysis of Usury Laws," *Journal of Bank Research (Winter 1980)*.

[2] See Richard Gustely and Harry L. Johnson, *Impact of the Tennessee Constitutional Usury Limit on the Tennessee Economy*, Center for Business and Economic Research, College of Business Administration, The University of Tennessee, Knoxville, Tennesseee (June 1977).

THE IMPACT OF HIGH INTEREST RATES ON BUSINESS

I do not deny that high real, or inflation-adjusted, interest rates adversely affect business. High interest charges increase costs for businesses that rely heavily on credit to finance inventory or crop production. Likewise, firms that sell on credit lose sales as prospective customers cancel or delay purchases because of high finance charges.

During 1981 and 1982, both real interest rates and the number of business failures rose to abnormally high levels. In 1982 alone, there were just over 25,000 business failures.[3] Approximately 12,000 of these were small businesses, if a "small business" is defined as one having less than $100,000 in liabilities. (However, the number of business firms in existence actually increased by more than 100,000 during 1982, in part because new incorporations far exceeded the number of business failures.)

Nevertheless, these high real interest rates did not result from a lack of competition among lenders in credit markets, which might be used as a justification for usury laws. On the contrary, the behavior of interest rates over the past several years can be explained in terms of the rational response of lenders and borrowers to adverse economic conditions, especially inflation, and to the Federal Reserve Board's highly erratic performance in trying to limit monetary growth in order to reduce inflation.

INTEREST RATES, INFLATION, AND MONETARY POLICY

Nominal interest rates begin rising in 1977 along with the rate of inflation. When prices are expected to rise, lenders require a higher nominal rate in order to offset the erosion of purchasing power on their loan principal. If investors' expectations of inflation are reasonably accurate, the real rate of interest will generally vary only by a small amount. By 1979, inflation had accelerated to an annual rate in excess of twelve percent as measured by the Consumer Price Index. The Federal Reserve Board therefore decided in October of 1979 to fight inflation by gradually reducing and stabilizing the growth of the money supply.

Since continuing inflation is caused by excessive monetary growth, the Fed's stated policy was the appropriate one. In addition, the adoption of an explicit rule for monetary growth created a highly visible gauge of the Fed's activities for financial markets.

Had the Fed performed as it promised to after the Fall of 1979, nominal interest rates would have declined along with inflation. Real interest rates would have remained at reasonable levels, since lenders would have observed the Fed hitting its monetary targets and, therefore, would have adjusted their estimates of future inlation accordingly. Rather than adhering to its stated policy, however, Federal Reserve officials repeatedly allowed M_1 to rise substantially above target for short periods of time and then "slammed on the monetary brakes."

The extremely volatile behavior of M_1 during 1980 and 1981 created enormous uncertainty among investors about the Fed's commitment to its own policy, and lenders maintained nominal interest rates at high levels for fear of renewed inflation. Thus, even though the Fed succeeded in reducing the average rate of monetary growth during this two-year period, nominal interest rates failed to fall along with inflation, and real interest rates rose to record levels.

It is important to realize that inflationary fears are not yet dead. This observation is underscored by the fact that the only period of sustained decline in interest rates occurred in the latter part of last sumer when M_1 fell within its target range. Since then, the Fed has allowed M_1 to grow at some of the highest rates in the entire postwar era; and the fall in nominal interest rates has slowed and, in some instances, reversed itself.

CONCLUSION

There does not appear to be any way in which usury laws could have kept real borrowing costs from rising during 1981 and 1982. In fact, had the Federal government not preempted the usury ceilings that were in effect in many states, the rate of business failure would probably have been higher than it actually was. To say that usury ceilings are the remedy for high interest rates is like prescribing a kick in the stomacch as a cure for a headache. Virtually all the available evidence confirms that when such restrictions result in artificially-low interest rates, credit supplies are reduced; non-interest borrowing costs are raised; and low-income and small-business borrowers are discriminated against by lenders. Action is clearly needed now to insure that such problems do not recur.

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[3] Source: Dunn & Bradstreet, Business Economics Division.

The CHAIRMAN. Thank you. Mr. Schotanus?

EUGENE L. SCHOTANUS, SENIOR VICE PRESIDENT, DEERE & CO., MOLINE, ILL.

Mr. SCHOTANUS. Thank you. I am Eugene Schotanus, vice president for Financial Services of Deere & Co. I might mention that I have submitted a longer statement for the record, in which we have included an analysis of the 50 State laws that are currently in existence. We made that analysis, because we have had a couple weeks now to try and comply with those laws.

Deere & Co. or John Deere, as it is more commonly known, manufactures and distributes farm and industrial equipment throughout the world. This past year we employed 48,000 people and had sales of $4.6 billion.

Our views on Senate bill S. 730 are shared by several trade associations: the Farm and Industrial Equipment Institute, or FIEI, representing 215 manufacturers of farm and specialized construction equipment, which employ approximately 250,000 people and have sales of $12.5 billion; also the Construction Industry Manufacturers Association, or CIMA, representing 200 manufacturers of heavy construction equipment, who again employ approximately 125,000 people and have sales of $17 billion; finally, the Associated Equipment Distributors, representing some 950 smaller businesses which sell, service and rent construction equipment, and which employ approximately 60,000 people, producing sales of $7.6 billion.

We and other members of these associations, support Federal preemption of State interest rate statutes for agricultural and business credit.

As a producer of capital goods, we also operate John Deere Credit Co. a wholly owned finance subsidiary, to help sell more of our products by making long-term credit available at interest rates which meet business customers' needs. We have no desire to be the sole source of credit to our customers, because our finance company competes for equity capital which would otherwise go into our manufacturing business. Modern farming and construction requires increasingly sophisticated and costly equipment. These businesses are also both seasonal and cyclical, meaning that both manufacturers and dealers require substantial inventories of equipment and parts. Production of capital goods also requires sophisticated and expensive manufacturing plants and equipment.

As a result, companies like John Deere encourage as much financing competition as possible, hoping to conserve our own capital resources to operate our basic businesses.

Currently, we are greatly concerned about the continued availability of enough credit for farmers and contractors. There has been growing use of credit by these customers, not only during the recent recession, but especially during the highly inflationary 1970s. For example, at John Deere, we have historically financed 40 to 50 percent of the value of our sales to end users. Over the past 3 years, that percentage has risen to over 70 percent.

SMALL BUSINESSES' CREDIT NEEDS INCREASED

As small businesses' credit needs have dramatically increased, the availability of funds from many traditional sources has not. While inflation has expanded credit needs, community bank lending didn't keep up. More recently, market forces and regulatory changes have further concentrated funds into the major money centers, sources which are far removed from the average farmer or small business borrower. Now, the budgets of Federal lending agencies are also under great pressure.

We urge you, once again, to help preserve existing agricultural and business credit sources. Any such efforts must also recognize the important role of the smaller finance companies, who, with lower credit ratings themselves, often borrow from banks at the prime rate or at higher rates in the bond market, yet continue to serve as important financial intermediaries. Continuation of Federal preemption for agricultural and business credit constitutes the single most important step which Congress can take to assure continued availability of credit for small businesses.

Over the past 3 years, Federal preemption for business and agricultural credit has been extremely beneficial. It has provided a stable and uniform regulatory environment which has enabled independent finance companies to establish offices nationwide to compete for equipment and other capital goods financing. It has also helped to overcome State legal barriers which are unrealistically restrictive even in normal times.

I have attached to my testimony, a description of how these restrictions apply to our own industry. Taken together, these laws constitute a complex, sometimes conflicting and often ambiguous barrier to uniform cost-efficient credit practices. This, ultimately, leads to higher costs to the buyer. This is particularly evident to companies with credit operations such as our own, who attempt to support a national product sales effort by conducting business on a consistent and fair basis throughout the 50 States.

Finally, preemption will provide a more consistent Federal policy. As you know, preemption already applies to a number of federally chartered lending agencies. The provision applicable to Farm Credit Administration loans which account for about one-fourth of nonreal estate farm lending today, is permanent, has no interest rate ceilings and does not provide the States the opportunity to remove themselves from its preemption.

You may be interested in how the continued absence of Federal preemption would affect our business. Our preliminary evaluation suggests that we would likely have to: First, drop some or all of our variable rate financing programs in 17 States and move to higher fixed-rate financing in those cases; and second, we will need to raise the minimum amounts required for financing in 6 States, and third, begin the costly process of changing the forms and procedures used in as many as 23 States.

While we strongly support preemption, the current formula does present some technical problems. These can easily be overcome either by renewing the legislation without an upper limit, as you are providing in S. 730, or by setting a threshold rate below which no limit would be operative, but above which a formula would govern.

We address these alternatives more specifically in my more detailed statement. If you do proceed on the basis of S. 730, we have some technical suggestions we would like to make and hope we may be in touch with your staff about those.

In summary, we do appreciate your willingness to consider the continuation of Federal preemption. We believe it is vital for small business and agriculture that this action be taken. We also ask your consideration of the technical improvements we have suggested.

Thank you very much.

[Complete statement follows:]

PREPARED STATEMENT OF EUGENE L. SCHOTANUS

SUMMARY

I am Eugene L. Schotanus, Senior Vice President, Financial Services, Deere & Company. Deere—or John Deere, as we are more commonly known—manufactures, distributes and finances farm and industrial equipment through-out the world. This past year we employed 48,000 people and had sales of $4.6 billion.

Our views on S. 730 are shared by several trade associations: the Farm and Industrial Equipment Institute, representing 215 manufacturers of farm equipment and specialized construction equipment which employ approximately 250,000 people and have sales of $12.5 billion; the Construction Industry Manufacturers Association, representing 200 manufacturers of heavy construction equipment which employ approximately 125,000 people and have sales of $17 billion; and the Associated Equipment Distributors, representing 950 businesses which sell, service and rent construction equipment, which employ approximately 60,000 people and have sales of $7.6 billion. We and other members of these associations support federal preemption of state usury statutes of agricultural and business credit.

As a seller of capital goods, we operate John Deere Credit Company, a wholly owned finance subsidiary, to help sell more of our products by making long-term credit available at reasonable rates which meet business customers' needs. We have no desire to be the sole source of credit to our customers. Our finance company competes for equity capital which would otherwise go into our manufacturing business. Modern farming and construction requires increasingly sophisticated and costly equipment. These businesses are seasonal and cyclical. Both manufacturers and dealers require substantial inventories of equipment and parts. Production of capital goods also requires sophisticated and expensive manufacturing plants and equipment. As a result, companies like Deere encourage as much lending competition as possible, conserving our own capital resources to operate our basic businesses.

Currently, we are greatly concerned about the availability of enough credit for farmers and contractors. There has been a growing use of credit by these customers, not only during the recent recession but during the inflationary 1970's. For example, we have historically financed 40 to 50 percent of our sales to end users. Over the past three years, that percentage has risen to 70 percent.

As small businesses' credit needs have dramatically increased, the availability of funds from many traditional sources has diminished. While inflation has expanded credit needs, community bank lending hasn't kept pace. Market forces and regulatory change have increasingly concentrated funds into major money centers—sources far removed from the average farmer or small business borrower. The budgets of federal lending agencies have been and continue to be under pressure.

We urge you to help preserve existing agricultural and business credit sources. Any such effort must recognize the important role of smaller finance companies with lower credit ratings who often borrow from banks at the prime rate or at higher rates in the bond market, yet serve as important financial intermediaries. Continuation of federal preemption for agricultural and business credit constitutes the single most important step which Congress can take to assure continued availability of credit for small businesses.

Over the past three years federal preemption for business and agricultural credit has been extremely beneficial. It has provided a stable and uniform regulatory environment which has enabled finance companies like our own to establish offices nationwide to compete for equipment and other capital goods financing. It has also helped to overcome state legal barriers which are unrealistically restrictive even in normal times. I have attached to my testimony a description of how these restrictions apply to our own industry, along with a summary of the relevant state laws. Taken together, these laws constitute a complex, sometimes conflicting and often ambiguous barrier to uniform, cost-efficient credit practices, which ultimately mean higher costs. This is particularly evident to those with credit operations such as our own, which attempt to support national product sales by conducting business on a consistent and fair basis throughout the 50 states.

Finally, preemption will provide a more consistent federal policy. As you know, preemption already applies to a number of federally chartered lending agencies. The provision applying to Farm Credit Administration loans—which account for about a fourth of non-real estate farm lending today—is permanent, has no interest rate ceilings and does not furnish states the opportunity to remove themselves from its preemption.

You may be interested in how the continued absence of federal preemption would affect our business. Our preliminary evaluation suggests that it is likely we will have to: (1) drop some or all of our variable rate financing programs in 17 states, moving to higher fixed-rate financing in these cases; (2) raise the minimum amounts required for financing in 6 states; and (3) begin the costly process of changing the finance forms and procedures used in as many as 23 states.

While we strongly supprot preemption, the current formula does present some technical problems which can be easily overcome by either renewing the legislation without an upper limit, as you do in S. 730, or by setting a threshold rate below which no limit would be operative but above which a formula would govern. We address these alternatives more specifically in my more detailed statement. If you do proceed on the basis of S. 730, we have some technical suggestions we would like to make and hope we may be in touch with your staff about those.

In summary, we appreciate your willingness to consider the continuation of federal preemption. We believe it is vital for small business and agriculture that this action be taken. We also ask your consideration of the improvements we have suggested. Thank you.

STATEMENT

I am Eugene L. Schotanus, Senior Vice President, Financial Services, Deere & Company. Deere—or John Deere, as we are more commonly known—manufactures, distributes and finances a broad line of farm and industrial equipment. This past year we employed 48,000 people and had sales of $4.6 billion. Nearly all of these sales were made through approximately 3,500 independent dealers who have over $1.4 billion of equity invested in their own businesses. We are the largest manufacturer of farm equipment in the world. We at John Deere commend you for seeking, in section two of S. 730, an extension and expansion of the current law preempting state interest rate ceilings for agricultural and business loans.

It is important that I emphasize several points at the outset of my testimony today. First, our views on S. 730 are shared by several important trade associations: the Farm and Industrial Equipment Institute, representing 215 manufacturers of farm equipment and specialized construction equipment, which employ approximately 250,000 people and have sales of $12.5 billion; the Construction Industry Manufacturers Association, representing 200 manufacturers of heavy construction equipment which employ approximately 125,000 people and have sales of $17 billion; and the Associated Equipment Distributors, representing 950 businesses which sell, service and rent construction equipment, which employ approximately 60,000 people and have sales of $7.6 billion.

Second, we approach the interest rate preemption issue from the point of view of a supplier of capital goods—productive equipment for farmers, contractors and other rather sophisticated small businessmen. We therefore do not discuss or take a position on section three of S. 730, which deals with the issue of consumer goods financing.

Third, we approach the preemption issue from the perspective of a seller of goods. John Deere Credit Company, our wholly owned subsidiary, is in business to help us do just that—to sell more of our products by seeing that credit is available at reasonable rates and on terms which best fit our business customers' unique financial needs. We have no desire to be the sole source of credit to our customers. Our captive finance company is not a bank. It must purchase all its funds. It can leverage its equity only four to five times at most. Because its equity capital comes from its parent company, it is in competition for dollars that can otherwise be used for increasing the productivity and efficiency of our manufacturing operations, carrying out research and development activities, holding inventories and for other similar business requirements. In short, we would like to encourage as much lending competition as possible, preferring to use our own capital resources in our basic businesses. However, we do continue to find that financing programs tailored to specific customer needs, such as seasonal payments, do help farmers and other businesses buy our products.

In this regard, we are concerned about the availability of credit for financing purchases of farm equipment and other capital goods used by farmers, contractors and other small businessmen. As you know, there has been a growing use of credit by these individuals not only during the recent recession but during the inflationary 1970's as well. As a result, there is growing evidence that credit sources are becoming more scarce. Let me illustrate with an example from our own experience. Historically, John Deere Credit Company has financed 40 to 50 percent of Deere & Company's sales to end users. That percentage has risen to nearly 70 percent during the past three years. In the past, many of our customers used our credit plan only briefly, until they marketed their crops. As a result, 50 percent or more of the loans we made were entirely prepaid during the first year. Today that proportion has declined to about 30 percent, as more of our business customers have begun using equipment loans in order to free up their other sources of funds for working capital. As a result, our protfolio of farmer and contractor notes has grown from about $1 billion several years ago to over $3 billion today. This is so even though Deere's sales down almost 25 percent due to the recession. As the economy and demand recover, the need for still additional customer financing could become staggering.

In order to address this situation, Congress should do all it can to preserve existing credit sources and not place obstacles in the way of further credit growth. Such an effort must necessarily consider smaller finance companies with lower credit ratings which often fund themselves from money-center banks at the prime rate, but nonetheless serve as important financial intermediaries.

The growing and future role of these financial intermediaries in agriculture and small business should not be underestimated. This is so for several reasons: First, the inflation rate between 1974 and 1981 of approximately 100 percent dramatically increased the value of everything to be financed. Rural and small community bank lending could not be expanded at that pace, and therefore these banks have been unable to meet their customers' needs. Second, a combination of capital market forces and deregulation has increased the concentration of the sources of credit far more into money-market funds, money-center banks and the Eurodollar market—sources far removed from the average farmer or small-business borrower. Finally, federal budget pressures appear to be deterring the continued growth of loans made to them under the authority of various government agencies.

So as the credit needs of farmers, contractors and other small businessmen have continued to dramatically increase, the availability of funds from traditional sources has actually diminished. General finance companies and other intermediaries should be encouraged to fill the remaining void. In the meantime captive finance companies such as our own are being forced to attempt to fill this need. However, we do not have the resources to do so.

As the economy begins to recover, the need for additional credit will be particularly great in the construction sector. The rescession has strained builders' balance sheets so severely that their initial sources of funds may only be secured equipment loans. This may also be true of many farmers. Finance companies, particularly captive companies, will need all the help they can get to support economic recovery.

Continuation of federal preemption for agricultural and business credit on a basis which will allow a reasonable return to financial intermediaries of the type I have mentioned constitutes the single most important step which Congress can take to remove obstacles to credit growth for small businesses in this country. Because of this we strongly support the purpose of section two of S. 730.

The federal preemption provisions for agricultural and business loans which have been in place over the past three years have proved to be extremely beneficial. They have provided a stable and uniform regulatory environment which has enabled finance companies to establish offices nationwide to compete for equipment and other capital goods financing. They have also acted as an essential "safety valve", preserving the availability and free flow of credit during periods of high and volatile interest rates, like the 1980-81 period.

Federal preemption of agricultural and business credit has also helped to overcome state legal barriers which are unrealistically restrictive even in normal times. It is difficult to appreciate the complexity of current state interest rate restrictions and the deterrent effect they can have on credit growth in individual states. In an attempt to illustrate this impact more clearly, I have attached a brief description of how these restrictions apply to our own industry along with a summary of the relevant state laws. Taken together, these laws constitute a complex, sometimes-conflicting and often ambiguous barrier to uniform, cost-efficient credit practices. That this is so is particularly evident in credit operations such as our own, which attempt to support national product sales by conducting business on a consistent and fair basis throughout the country. Federal preemption of interest rate ceilings for business and agricultural loans would help overcome this barrier. It would minimize legal and administrative costs and allow a single, consistent rate to be established for all business customers.

A related point which should be mentioned here is that federal preemption will also help overcome an increasing number of technical errors and oversights in current state laws. For example, in nine states where some type of floating rate ceiling has been adopted, the impact of the statutory language on variable rate loans does not seem to have been adequately considered. In these states variable rate loans cannot have a rate higher than that allowed by the statutory formula on the date the extension of credit takes place. That is, the rate may in the future go down, but not up. Of course this effectively undermines the variable rate concept, forcing lenders to charge a fixed rate, which must necessarily be higher. It seems doubtful that this result was ever directly considered.

Because there is already a good deal of precedent for federal preemption, its continuation in the area of agricultural and business credit will provide a more consistent and fair federal policy. A permanent preemption already exists for home mortgage loans; loans made by national banks, state-chartered federally-insured banks, savings and loan institutions, credit unions and small business investment companies; and loans for agricultural purposes made under the authority of the Farm Credit Administration. The preemption provision applying to Farm Credit Administration loans—which that agency indicates account for about a fourth of non-real estate farm lending today—is permanent, has no interest rate ceilings and does not furnish states the opportunity to remove themselves from its preemption.

You may be interested in how the continued absence of federal preemption would affect our business. Our preliminary evaluation suggests that it is likely we will have to: (1) drop some or all of our variable rate financing programs in 17 states, moving to higher fixed-rate financing in these cases; (2) raise the minimum amounts required for financing in 6 states; and (3) begin the costly process of changing the finance forms and procedures used in as many as 23 states.

In urging federal preemption for agricultural and business credit, we would be remiss if we did not comment on alternative methods of accomplishing this. The federal statute which expired on April 1 dealt rather effectively with the problem of soaring interest rates in the 1980-81 period. However, since interest rates in general have moderated, the federal formula is, in effect, setting interest rates and thereby discouraging lending by financial intermediaries. The federal discount rate is a proxy for short-term interest rates, yet it is dictating the rate on multiyear, or intermediate term, credits. For example, a single-A rated finance company would likely have to pay today nearly 12 percent for 3-5 year term funds in the public bond markets. The existing formula would permit charging customers only 13½ percent, based upon an 8½ percent discount rate plus the 5 percent additive. If one realistically incorporates 1-2 percent for various administrative costs, including in some cases insurance, there is little incentive for such an intermediary to lend.

There are several alternatives to this problem. One is to provide for federal preemption with no ceiling as Congress has done for the private credit institutions operating under the authority of the Federal Farm Credit Administration. This is, of course, the free market position taken in S. 730. While we, too, are advocates of a free market, it is possible that such an approach may not have adequate political appeal or could cause more states to "opt out" of the federal law than might otherwise be the case if a slightly different approach were taken.

One alternative would be to improve the existing federal formula so that it operates effectively in both low and high interest rate periods. This would require a formula which would reflect the differences in short and long-term rates and incorporate a risk premium reflective of finance companies' costs of funds. Although we could support such a formula, it might be rather complex.

A simple and more practical alternative would be to specify some level of interest rates, perhaps in the 16 percent to 18 percent range, above which the federal formula would apply but below which the formula would be inoperative, letting the market determine interest rates. The rationale for this approach is simple: Interest rate ceilings are based on the legal and moral concepts of usury. These concepts have been incorporated into our state laws for many years. If one analyzes the various states' laws prior to the 1980 federal legislation, two facts become evident. First, all states recognized that there was some level of interest rates below which they would not intervene and instead allow market forces to determine interest rates. In some cases this meant that there were no ceilings at all. In other cases these ceilings were quite low. Second, over 75 percent of the states concluded that rates under 18 percent were not usurious; 84 percent concluded that rates under 16 percent were not usurious. This data suggests to us that any formula ought to be applicable only at levels of 16-18 percent or more. Such a formula would then protect the public from usury during periods of high interest rates when usury is an issue. Below those levels, market forces could be allowed to determine rates. This would prevent the federal formula from inadvertently setting rates and discouraging the availability of credit through financial intermediaries as is occurring today.

Mr. Chairman, we commend you for your efforts to continue federal preemption for agricultural and business credit. We believe it is vital for agriculture and small business that this action be taken.

DEERE & COMPANY

JOHN DEERE ROAD, MOLINE, ILLINOIS 61265 U.S.A

STATE LEGAL LIMITS APPLICABLE TO THE FINANCING OF SALES OF AGRICULTURAL AND INDUSTRIAL (CONSTRUCTION AND FORESTRY) EQUIPMENT

Principal Financing Techniques in the Agricultural and Industrial Equipment Industries

Most full line agricultural and industrial equipment companies, including Deere & Company, use "captive" credit companies to routinely provide their U.S. business customers with credit at competitive rates. This allows customers, particularly during times of generally tight credit, to obtain the funds necessary to make needed purchases. It also allows the companies to make sales which might otherwise be lost. Companies which manufacture and sell a more limited line of equipment usually either provide credit to their customers through independent finance companies with whom they have established an ongoing business relationship or else they encourage their customers to obtain credit on their own through a finance company or bank.

Until recently, non-bank financing for sales of agricultural and industrial equipment was primarily carried out through the use of fixed-rate retail installment sales contracts or fixed-rate loans, under which the customer was charged a fixed-rate of interest or finance charge throughout the life of the contract. Today, because recent fluctuations in the interest costs of lenders have made a reasonable fixed-rate difficult to establish, fixed-rate financing is gradually being abandoned. It is being replaced with variable-rate programs involving either variable-rate retail installment sales contracts or variable-rate loan agreements.

Under a variable-rate retail installment sales contract or loan agreement, the customer's rate of interest is tied to a base rate outside the control of the lender (e.g. the prime rate). Typically there is an additive of two to three percent over the base rate. Under financing offered by Deere & Company, payments are made in constant amounts on a monthly or seasonal basis, usually over a three to five-year period. Any necessary adjustments needed because of interest rate fluctuations during the contract period are made by increasing or decreasing the final installment payment. An increase in excess of one-half of the scheduled final installment results in an automatic extension of the payment period.

State Legal Limitations on Agricultural and Industrial Equipment Financing

Nearly all state laws establishing interest rate ceilings and other restrictions on credit were developed prior to the use of variable-rate financing. The oldest -- and typically most restrictive -- of these are the state usury laws. These laws, which establish an interest rate ceiling on "loans or other forbearances of debt", normally apply to direct loans to purchase equipment. Their applicability to fixed-rate retail installment sales contracts depends upon whether state courts have adopted the so-called "time-price doctrine". Under this doctrine, when goods are purchased over time pursuant to a purchase contract, the difference between the "cash price" and the "time-price" -- that is, the "time-price differential" -- is not "interest" in the sense meant by usury laws. This doctrine, in essence, permits retail installment sales financing without any usury interest limits. In states where the doctrine has not been adopted, usury ceilings continue to apply to fixed-rate retail installment sales contracts unless a retail installment sales act supersedes the usury laws.

The adoption of the "time-price doctrine" by a majority of courts led in the 1950's to the passage of a number of state retail installment sales acts. These acts, which vary considerably in scope, regulate retail installment sales both as to rates and other terms. While they apply primarily to consumer goods -- goods purchased for personal, family or household purposes -- in a number of cases they also cover sales of agricultural equipment, industrial equipment and other business sales. States have also adopted a number of specialized installment sales acts. Some of these, such as several which apply to motor vehicle sales, are also drafted broadly enough to cover agricultural and industrial equipment sales.

The introduction of variable-rate installment sales contracts and variable-rate loans has added a new level of complexity to the already confusing patchwork of state laws limiting extensions of credit. In states with usury laws where courts recognize the "time-price doctrine", variable-rate retail installment sales contracts do not meet the test upon which the doctrine depends -- a fixed time-price. This is so because the "price" varies with changes in the interest rate. Accordingly, in such states these arrangements are now subject to the state's usury laws. Variable-rate loans continue to be subject to state usury laws just as fixed-rate loans were.

While most state retail installment sales acts do not explicitly recognize the concept of variable rate financing, neither do they prohibit its use. Consequently these acts usually continue to apply to variable-rate retail installment sales contracts. Variable-rate loans do not typically fall within the scope of such acts.

Status of the State Law Today

A summary of current state legal limits applicable to the financing of sales of agricultural and industrial equipment is attached as Exhibit A.

Detailed analysis of the state statutes in this area leads one to the following conclusions: 1) some state ceilings are unrealistically low in terms of the market rates at which lenders must borrow, 2) state interest rate ceilings on credit transactions involving similar dollar amounts vary significantly from state to state, 3) between -- and even within -- states, ceilings for credit transactions involving essentially similar goods vary significantly, and 4) determining the restrictions imposed by the state laws is in many cases difficult. Adoption of variable-rate financing has added a new level of ambiguity and confusion to this process.

8 December 1982
L. Ronald Modlin
Law Department, Deere & Company

EXHIBIT A

7 December 1982
Revised 3 March 1983

STATE RETAIL AND USURY RATE LIMITATIONS APPLICABLE TO FINANCING OF SALES OF AGRICULTURAL AND INDUSTRIAL (CONSTRUCTION AND FORESTRY) EQUIPMENT

Explanatory Note: Please see the last page for explanation of all abbreviations used in this summary.

Also, unless otherwise noted, all usury limitations, and all limiting amounts stated in the column for Laws Regulating Fixed- and Variable- Rate Loans are based on the loan amount. This is in contrast to several of the state retail acts, in which the limiting amounts may be based either on the Cash Price (CP) of the item, or the Amount Financed (AF), as noted.

Finally, it should be noted that where the Time-price doctrine controls, the financing rate is open - that is, any finance charge agreed to by the parties may be taken.

	Laws Regulating Fixed-Rate (FR) Retail Installment Contracts	Laws Regulating Variable-Rate (VR) Retail Installment Contracts	Laws Regulating Fixed- and Variable-Rate Loans
ALABAMA	Code of Ala. Title 5, Chap. 19 covers Ag & Ind - Under $5000 (AF), 18% (Sec.5-19-3); over $5000 (AF), open (Sec. 8-8-5); alternative rate: prime rate (as reported by the three largest N.Y.C. banks) + 2% (Sec. 8-8-14)	same as FR	same as FR
ALASKA[3]	RISA - does not cover Ag or Ind; Time-price (open rate) applies	Usury - to $25,000, F.D.R. + 5%;[1] over $25,000, open (Sec.45.45.010)	same as VR
ARIZONA	MV Time Sales Disclosure Act - covers Ind (forestry), open rate (Sec.44-291) RIST - covers Ag and Ind (except forestry), open rate (Sec.44-6002)	same as FR	usury - open rate (Sec.44-1201)
ARKANSAS[3]	No retail act; Time-price abrogated; usury - FDR + 5% (Ark. Constitution, Amendment 60)	same as FR	same as FR

[1] The Federal Discount Rate is reported as it is stated in the statute. Thus, surcharge exclusion or inclusion is noted only when it specifically appears in the statute.

[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%.

CALIFORNIA[3]	RIS and Automobile Sales Finance Act - do not apply to Ag or Ind; Time-price (open rate) applies	usury - greater of 10% or F.D.R. + 5% (Const. Art. XV Sec. 1)	same as VR
COLORADO [2]	UCCC - sales of Ag or Ind to $3000 (AF), 21% (Sec.5-2-602); over $3000 (AF), open (Sec.5-2-605), but cap of 45% (Sec.5-12-103)	same as FR	UCCC - loans for Ag and Ind to $3000, 21% (Sec.5-3-508); over $3000, 45% (Sec.5-3-605)
CONNECTICUT[3]	RISF - Ag & Ind sales, to $8000 (CP), 21% (Sec.42-85); over $8000 (CP), Time-price (open rate) applies	under $8000, same as FR; over $8000, usury - $8000-$10,000 - 12% (Sec.37-4); over $10,000, open, if business purpose (Sec.37-9)	usury - to $10,000, 12% (Sec.37-4); over $10,000, open, if business purpose (Sec.37-9)
DELAWARE [3]	MV Sales Finance Act - self-propelled Ag & Ind equipment - open rate (Sec.2907); all other items, Time-price (open rate) applies	same as FR for self-propelled; for all non-self-propelled, usury - Corp. rate, open (Tit. 6, Sec. 2306); Indiv. rate[4] to $100,000, FDR (incl. surcharge) + 5%; over $100,000, open (Tit. 6, Sec. 2301)	usury - as per VR
FLORIDA	RISA & MVSFA - do not apply to Ag or Ind; Time-price (open rate) applies	usury - to $500,000, 18% (Sec.687.02); over $500,000, 25% (Sec.687.02 & 687.071)	same as VR
GEORGIA[3]	RISA & MVSFA - do not apply to Ag or Ind; Time-price (open rate) applies	usury - to $3000, 10.5% (Sec.57-101); $3000 to $100,000, open, if business purpose (Sec.57-118); over $100,000, open (Sec.57-119)	same as VR

[2] States which have rejected Federal Preemption

[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%

[4] Unless otherwise noted, Individual (Indiv.) usury rates include partnerships, sole proprietorships and individuals.

HAWAII[2,3]	RISA - all Ag and Ind Sales, 14% - 4% Add-on graduated rate (14% Add-on - 1st 18 months; 10-1/2% Add-on next 12 months; 7% Add-on next 6 months; 4% Add-on next 6 months) (Sec.476-33 & 408-15)	same as FR	usury - to $750,000, 12% (Sec.478-3); over $750,000, open (Sec. 478-8)
IDAHO	UCCC - sales of Ag to $70,000 (AF), 21% (Sec. 28-32-104 & 28-32-201); Ind to $70,000 (AF), 21% (Sec.28-32-602); over $70,000 (AF), open (Sec. 28-32-605)	same as FR	UCCC - loans for Ag and Ind to $70,000, 21% (Sec.28-33-104, 28-33-201 and 28-33-602); over $70,000, open Note: Idaho has deleted the UCCC provision permitting open loan charges; therefore, this limitation is based on usury (Sec.28-22-105)
ILLINOIS	RISA & MVRISA - do not apply to Ag or Ind; Time-price (open rate) applies	usury - Corp. rate, open (Sec.4 of Rev. Stat. 74); Indiv. rate, open, if business purpose (Sec.4 of Rev. Stat. 74)	same as VR
INDIANA	UCCC - sales of Ag to $55,000 (AF), 21% (Sec. 24-4.5-2-104 & 24-4.5-2-201); Ind to $55,000 (AF), 21% (Sec.24-4.5-2-602); over $55,000 (AF) open (Sec. 24-4.5-2-605)	same as FR	UCCC - loans for Ag & Ind to $55,000, 21% (Sec.24-4.5-3-605); over $55,000, open (Sec.24-4.5-3-605)
IOWA[2]	ICCC - does not apply to Ag or Ind; Time-price abrogated; usury - Corp. rate, open (Sec.535.2); Indiv. rate, open if business purpose (Sec. 535.2)	same as FR	usury - same as FR

[2] States which have rejected Federal Preemption

[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%

KANSAS	KCCC - does not apply to Ag or Ind; Time-price (open rate) applies	usury - Corp. rate, open (Sec. 17-7105); Indiv. rate, open if Ag or business purpose (Sec. 16-207)	same as VR
KENTUCKY[3]	ISC & MVRISA do not apply to Ag & Ind; Time-price (open rate) applies	usury - Corp. rate, open (Sec. 360.025); Indiv. rate, to $15,000, lesser of 19% or FDR + 4%; over $15,000, open (Sec.360.010)	same as VR
LOUISIANA[3]	Consumer Credit Act - covers Ag sales, 18% (Sec.9:3520); Ind sales - CCA does not cover, Time-price (open rate) applies	Ag - same as FR; Ind - usury, Corp. rate - open (Sec.12: 704 & 9:3509); Indiv. rate - open, if business purpose Sec. 9:3509)	usury - Ind, same as VR; Ag - CCA applies to Ag loans: to $1,400, 36%; $1,400 to $4,000, 27%; $4,000 to $7,000, 24%; over $7,000, 21% (Sec. 9:3519)
MAINE	Me. CCC - does not cover Ag or Ind; Time-price (open rate) applies	usury - open, if commercial purpose (Tit. 9-B, Sec. 432)	same as VR
MARYLAND[3]	CLA - RIS - covers Ag & Ind sales, 24% (Sec. 12-609) Note: Due to an ambiguity in the definition of a motor vehicle under the Maryland statute, there is some question whether sales in excess of $12,500 would be covered. If the Act does not apply to sales over $12,500 (CP), Time-price (open rate) would apply.	CLA - PIS covers Ag & Ind sales on the same basis as FR. VR agreements permitted (a) if Fed. Pre-empt is relied upon for rate; or (b) a rate no greater than 16.5% on new equipment (22% on used equipment less than two years old; 27% on used equipment more than two years old) is taken (Secs. 12-609(f) & 12-610(3)). If neither (a) nor (b) followed, fixed-rate contracts must be used.	usury - to $5,000, VR loans permitted if (a) Fed. Pre-empt is relied upon for rate; or (b) a rate no greater than 6% is taken (Secs. 12-102 and 12-118); over $5,000, VR or FR loans permitted at any rate (Secs. 12-103(e) & 12-118)

[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%.

MASSACHUSETTS[2]	RISS & MVRIS do not apply to Ag or Ind; Time-price (open rate) applies	usury - open (Ch. 107, Sec.3)	same as VR
MICHIGAN	RISA & MVRISA - do not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. rate - open (Sec.275); Indiv. rate - open, if individual signs sworn statement of business purpose and loan is by finance subsidiary of a manufacturing corporation (Sec.438.61)	same as VR
MINNESOTA[3]	MVRISA - does not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. rate, open (Sec. 334-021); Indiv. rate - under $100,000, F.D.R. + 4-1/2% (Sec.334.011); over $100,000, open (Sec.334.01)	same as VR
MISSISSIPPI[3]	MVSFL - does not apply to Ag or Ind; Time-price (open rate) applies	usury - Corp. rate - to $2500, greater of 10% or F.D.R. (excluding surcharge) + 5%; over $2500, greater of 15% or F.D.R. (excluding surcharge) + 5% (Sec.75-17-1); Indiv. rate - greater of 10% or F.D.R. (excluding surcharge) + 5% (Sec.75-17-1); alternative rate - to $2,500, 24%; over $2,500, 21% (Sec. 75-17-1(6))	same as VR (except: alternative rate not available)

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[2] States which have rejected Federal Preemption

[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%

MISSOURI[3,5]	RCSL - does not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. rate - open (Sec. 408.035 & 408.060); Indiv. rate - to $5000, greater of 10% or monthly U.S. Gov't bond yields + 3%; over $5000, open, if business purpose (Sec.408.035)	same as VR
MONTANA[3]	RISA - covers Ag and Ind sales, to 1 July, 1983, open (Sec.31-1-241)	same as FR	usury - Corp. & Indiv. rate - to $150,000, greater of 10% or F.D.R. + 4%; $150,000 to $300,000, greater of 10% or F.D.R. + 5%; over $300,000, open (Sec.31-1-107)
NEBRASKA[2,3]	ISA - covers Ag and Ind, 18% (Sec.45-338)	same as FR	usury - Corp. rate - open (Sec.45-101.04); Indiv. rate - 16% (Sec.45-101.03)
NEVADA[2]	RISGS - does not apply to Ag or Ind; Time-price (open rate) applies	usury - Corp. and Indiv., open (Sec.99.050)	same as VR
NEW HAMPSHIRE	RISMV - covers Ind (forestry only) under $7500 (CP), open (Sec.361-A:8); Ag, Ind (all except forestry) and all Ind over $7500 (CP), Time-price (open rate) applies	same as FR	usury - Corp. and Indiv. rate-open (Sec.336:1)

[2] States which have rejected Federal Preemption

[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%

[5] States in which a finance rate is tied to a variable other than the Federal Discount Rate

NEW JERSEY[3]	RIS does not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. rate - open (Sec. 31:1-6); Indiv. rate - to $1000, 16%; $1000 to $50,000, F.D.R. (including surcharge) + 5%; over $50,000, open (Sec. 31:1:1)	same as VR
NEW MEXICO	RISA does not cover Ag or Ind; MVSFA covers Ag, open until 1 July 1983 (Sec.58-19-8); Ind, no coverage, Time-price (open rate) applies	Ag - same as FR; Ind - usury Corp. rate, open (Sec.56-8-21 & Ch.263 Sec.1); Indiv. rate, open (Ch.263 Sec.1)	usury - Corp. rate, open (Sec.56-8-21 & Ch.263 Sec.1); Indiv. rate, open (Ch.263 Sec. 1).
NEW YORK[3]	RISA & MVRISA do not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. rate, open (Sec.521); however, 25% is criminal usury (Sec.190.40 of the penal law); Indiv. rate - to $250,000, 16% (Sec. 501); $250,000 to $2,500,000 open but subject to 25% criminal usury rate (Sec. 501); over $2,500,000, open, no criminal usury limit (Sec.501)	same as VR
NORTH CAROLINA[3,5]	RISA & MVDMLL do not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. rate - open (Sec.24-9); Indiv. rate - to $25,000, greater of 16% or six-month U.S. T-Bill rate + 6%; over $25,000, open (Sec.24-1.1)	same as VR

[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%

[5] States in which a finance rate is tied to a variable other than the Federal Discount Rate

NORTH DAKOTA[3,5]	RISA - covers Ind sales to $25,000 (CP) and all Ag, open (Sec.51-13-03); Ind over $25,000 (CP), Time-price (open rate, Laws 1979, H.B. 1388, Sec.2) applies	Ind to $25,000 and all Ag - same as FR; Ind. over $25,000, usury - Corp. rate, open (Sec.47-14-09); Indiv. rate, to $35,000, greater of 7% or 6-month U.S. T-Bill rate + 5-1/2%; over $35,000, open (Sec.47-14-09)	usury - as described under VR
OHIO[3]	RISA - covers Ag and Ind, 25% (Sec.1317.061)	same as FR	usury - Corp. rate, open (Sec.1701.68); Indiv. rate, to $100,000, 8%; over $100,000, open (Sec.1343.01)
OKLAHOMA	UCCC - covers Ag and Ind sales, open (Sec. 14A-2-605)	same as FR	UCCC - covers Ag and Ind, 45% (Sec.14A-3-605 and 14A-5-107)
OREGON[3]	RIS & MVRISA do not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. and Indiv. rate - to $50,000, greater of 12% or F.D.R. (including surcharge) + 5%; over $50,000, open (Sec.82.010 & Ch. 412 Sec.10)	same as VR
PENNSYLVANIA[3]	GSISA & MVSFA - do not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. rate - open (Art.III Ch.13); Indiv. rate - to $10,000, 6% (Art. II Sec.201); over $10,000, open, with affidavit of business purpose (Art.III Sec.301 & Tit.10 Sec.7.2)	same as VR

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[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%

[5] States in which a finance rate is tied to a variable other than the Federal Discount Rate

RHODE ISLAND[5]	TILRSA covers Ag and Ind, 21% (Sec.6-27-4)	same as FR	TILRSA covers Ag & Ind loans, 21% (Sec. 6-27-4)
SOUTH CAROLINA[2]	SCCPC - covers Ag and Ind sales, open (Sec. 37-3-101)	same as FR	SCCPC - covers Ag and Ind; Ag loans under $25,000, 18% (Sec.37-10-104); Ag loans over $25,000 and all Ind loans, open (Sec.37-3-605)
SOUTH DAKOTA[2]	MVRISA - covers all Ag except non-self-propelled, non-tractor attachments, and all self-propelled Ind., open (Sec.54-7-36); ISC - covers non-self-propelled, non-tractor attachments, open (Sec.54-3A-3); time-price abrogated, for non-self-propelled Ind, usury - Corp. and Indiv. rate, open (S.B. 178 Sec. 1)	usury - as per FR, open rate	ISC - covers loans for non-self-propelled, non-tractor attachments, open (Sec. 54-3A-3); all other loans, usury - as per FR, open rate
TENNESSEE[3]	RISA - does not cover Ag or Ind; Time-price (open rate) applies	usury - Corp. and Indiv. rate - lesser of 18% or F.D.R. + 5% (Sec. 47-14-103 & 47-14-102)	same as VR
TEXAS[5]	RIS and MVIS - do not apply to Ag or Ind; Time-price (open rate) applies	usury - Corp. and Indiv. rate - to $250,000, 2 times 26-week U.S. T-Bill rate: if under 18%, 18% is ceiling; 18% to 24%, formula is ceiling; over $250,000, 28% (Tit.79, Art.1.04)	same as VR

[2] States which have rejected Federal Preemption

[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%

[5] States in which a finance rate is tied to a variable other than the Federal Discount Rate

UTAH	UCCC - sales of Ag to $70,000 (AF), 18% (Sec. 70B-2-104 & 70B-2-201); Ind to $70,000 (AF), 18% (Sec.70B-2-602); over $70,000 (AF), open (Sec. 70B-2-605) Note: effective 23 Sept. 1982, Reg. A68-01-19 of the Dept. of Financial Institutions may have deleted all coverage of Ag from the UCCC. Clarification of the Regulation is being sought.	same as FR	UCCC - loans for Ag to $70,000, 18% (Sec.70B-3-104 & 70B-3-201); Ag loans over $70,000 and all Ind loans, open (Sec.70B-3-605) See Note under FR.
VERMONT	RISA - does not cover Ag or Ind; MVRISFA covers Ag and Ind self-propelled and attachments under $20,000: new, 18%; 1 yr. or older, 20% (Tit. 9 Sec. 2556a & Tit. 9 Sec.41a); Ag and Ind over $20,000, Time-price (open rate) applies	Ag & Ind under $20,000, same as FR; Ag and Ind over $20,000, usury - Corp. & Indiv. rate, open (Tit.9 Sec. 46)	usury, as per VR
VIRGINIA[3]	CC - does not cover Ag or Ind; MVDLA covers Ag and Ind self-propelled products, but does not provide rate language; Time-price (open rate) applies to self-propelled Ag & Ind	usury - Corp. rate - open (Sec. 6.1-330.43); Indiv. rate - to $5,000, 8% (Sec. 6.1-220.11); over $5,000, open, if business purpose (Sec.6.1-330-44)	same as VR
WASHINGTON	CDA does not cover Ag or Ind; Time-price abrogated; usury - Corp. rate - open (Sec. 29.52.080); Indiv. rate - open, if business or agricultural purpose (Sec.29.52.080)	usury - as per FR	same as VR

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[3] States in which some portion of the allowable finance rate is (or may be, if the state has a variable ceiling) below 18%

WEST VIRGINIA[3]	WVCCPA - covers Ag under $25,000 (AF), to $1500 (AF), 18%; over $1500 (AF), 12% (Sec. 46A-3-101); Ag over $25,000 (AF) and Ind - Time-price abrogated; usury - Corp. rate, open (Ch. 47, Art.6, Sec.10); Indiv. rate - Ag, $6 Add-on (Sec.47-6-5a & Ch.47, Art. 6 Sec.11); Ind, to $20,000, $6 Add-on; over $20,000, open (Sec. 47-6-6-5a & Ch.47, Art.6 Sec.11)	same as FR	WVCCPA - covers Ag loans to $25,000; under $2,000, 8% (or license required) (Secs. 46A-1-102(45) & 46A-4-101); $2,000 to $25,000, $6 add-on, or alternate rate as established by the Commissioner of Banking (not to exceed F.D.R. + 1%) (Secs. 46A-3-104, 46A-3-104(a), 47-6-5(a) & 31A-4-30(a)); Ag over $25,000 and all Ind, usury - as per FR
WISCONSIN[5]	WCA - covers Ag under $25,000 (AF), open (Sec.422-201); Ag over $25,000 (AF) and all Ind, Time-price abrogated; usury - Corp. rate - open (Sec.138.05); Indiv. rate - open (Sec.138.,05)	Same as FR	WCA - covers Ag loans to $25,000, greater of 18% or 6 month U.S. T-Bills + 6% (Sec. 422.201); Ag over $25,000 and all Ind, usury - as per FR
WYOMING	UCCC - covers Ag and Ind, to $25,000 (AF), 21% (Sec.40-14-257); Ag & Ind over $25,000 (AF), open (Sec.40-14-261)	same as FR	UCCC - covers Ag & Ind, to $25,000, 21% (Sec.40-14-442 & 40-14-348); over $25,000, open (Sec.40-14-445)

[2] States which have rejected Federal Preemption

[5] States in which a finance rate is tied to a variable other than the Federal Discount Rate

ABBREVIATIONS AND EXPLANATIONS:

Act Abbreviations:

CCC - Consumer Credit Code

CLA - Commercial Law Article

MVRISFA - Motor Vehicle Retail Installment Sales Finance Act

RIS(A) - Retail Installment Sales (Act)

RISS - Retail Installment Sales and Services

SCCPC - South Carolina Consumer Protection Code

TILRSA - Truth in Lending and Retail Sales Act

UCCC - Uniform Consumer Credit Code (1969)

WVCCPA - West Virginia Consumer Credit and Protection Act

General Abbreviations and Explanations:

Add-on -	a method for calculating finance charge which permits the stated rate to be taken each year on the original principal balance of the loan for the entire term of the loan, despite the fact that the loan is repayable in installments.
AF -	amount financed. The amount of credit extended to the purchaser.
Ag -	agricultural equipment.
CP -	cash price. The sale price of the equipment.
Corp. rate -	the rate of interest which may be charged to a corporation under state usury laws.
FDR -	Federal Discount Rate. The interest rate at which member banks can borrow from Federal Reserve Banks.
FR -	fixed rate. Refers to a finance rate which remains constant throughout the term of the contract or loan.
Ind -	industrial (construction and forestry) equipment.
Indiv. rate -	the rate of interest which may be charged to a person, partnership or sole proprietorship under state usury laws.
MV -	motor vehicle.
open -	refers to the absence of a rate ceiling - that is, permits the charging of any rate of interest agreed to by the parties.
Time-price -	a court-created doctrine which permits a seller to charge one price for goods purchased for immediate cash, and another price for goods paid for at a future date or in installments. The difference between these prices is the time-price differential. In practice, this doctrine permits charging any rate of interest agreed to by the parties.
VR -	variable rate. Refers to a finance rate which may fluctuate throughout the term of the contract or loan.

The CHAIRMAN. Thank you very much. Gentlemen, your full statements will be printed in the record. Mr. Palmer.

LEE PALMER, PRESIDENT, HEARTHSTONE GROUP, MILWAUKEE, WIS., ON BEHALF OF SMALL BUSINESS UNITED AND INDEPENDENT BUSINESS ASSOCIATION OF WISCONSIN

Mr. PALMER. Mr. Chairman, members of this committee, my name is Lee Palmer, president of the Hearthstone Group, a Wisconsin holding company owning several small businesses.

I am a director of the Independent Business Association of Wisconsin, which has a statewide membership of about 1,000 small and independent businesses. I also serve on the board of directors of Small Business United [SBU], a consortium of 16 local, State, and regional associations, representing over 50,000 small businesses nationwide.

I am testifying today on behalf of both IBAW and SBU. The organizations I represent support S. 730, the Credit Deregulation and Availability Act of 1983. We see this measure as the next logical step in the deregulation of the supply and demand of credit. Small business generally feels that regulation of any kind should be used only as a last resort. We feel that the operations of financial markets today do not justify continuation of laws designed to deal with dated problems.

As you know, S. 730 preempts State usury laws, except where those States take positive action to retain such laws. Regardless of the intent, the effect of usury laws is a government allocation of credit. Such allocations defeat the whole purpose of financial deregulation. Usury laws, of course, are a form of price control. We are particularly concerned about attempts to control the price of financial resources which, when put to work in small businesses, have the opportunity to create jobs. As the Nation's job creator, small business is eager to meet the employment challenge of the 1980's and 1990's. Obviously, the challenge will be difficult enough without price controls on our most basic commodities.

We in small business are particularly concerned about the availability of credit in fiscal year 1984 and beyond. The demand for funds needed to finance outrageously large Federal budget deficits will impose a tremendous burden on the credit markets. As it is, small business will have enough difficulty dealing with crowding out. The effects of usury laws will exacerbate the crisis and eliminate access to credit for many firms. As you know, credit flows through the financial markets to those who are able to provide the greatest return. That return may be measured in terms of immediate rewards or long-term prospects for a value customer. Either way, any government-imposed limit on the return availability to the supplier of credit will cause that supplier to send those funds to those areas which will offer unrestricted return.

In the future, we believe that will be the obligation of the U.S. Treasury, various government agencies and large corporations. Small business will be shut out. We suspect that since many State legislatures do not meet annually, they will be unable to deal with the credit availability crisis on a timely basis.

Senate bill 730 addresses the problem before it becomes an emergency matter. SBU and IBAW urge the members of the committee to favorably report S. 730, and we hope the Senate deals with the measure as soon as possible.

Thank you for the opportunity to present our views on this issue. I would be happy to answer any questions you may have.

[The complete statement follows:]

sbu
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A NATIONAL NETWORK
FOR LEGISLATIVE ACTION

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Presentation
May 3-4, 1983

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STATEMENT OF

LEE PALMER

DIRECTOR, INDEPENDENT BUSINESS ASSOCIATION
OF WISCONSIN (IBAW)

AND

BOARD OF DIRECTORS
SMALL BUSINESS UNITED

BEFORE THE

U.S. SENATE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS

ON

S. 730 - "THE CREDIT DEREGULATION AND
AVAILABILITY ACT OF 1983"

APRIL 12, 1983

MR. CHAIRMAN AND MEMBERS OF THIS COMMITTEE:

My name is Lee Palmer. I am President of the Hearthstone Group, a Wisconsin holding company owning several small businesses. I am a director of the Independent Business Association of Wisconsin (IBAW), which has a statewide membership of about 1,000 small and independent businesses. I also serve on the Board of Directors of Small Business United (SBU), a consortium of 16 local, state and regional associations representing over 50,000 small business nationwide. I am testifying today on behalf of both IBAW and SBU.

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As you know, credit flows through the financial markets to those who are able to provide the greatest return. That return may be measured in terms of immediate rewards or long-term prospects for a valued customer. Either way, any government-imposed limit on the return available to the supplier of credit will cause that supplier to send his funds to those areas which offer an unrestricted return. In the immediate future, we believe that will be the obligation of the U.S. Treasury, various government agencies, and large corporations. Small business will be shut out. We suspect that since many state legislatures do not meet annually, they will be unable to deal with credit availability crises on a timely basis. Senate bill 730 addresses the problem before it becomes an emergency matter.

SBU and IBAW urge the Members of the Committee to favorably report S. 730 and we hope the Senate deals with the measure as soon as possible.

Thank you for the opportunity to present our views on this issue. I would be happy to answer any questions you may have.

The CHAIRMAN. Thank you very much.

Gentlemen, let me ask you the same question I asked the regulators about, when interest rate ceilings are too restrictive, lenders often turn to noninterest conditions such as increasing downpayments, shorter loan maturities, increased noninterest fees and charges, and in the case of retailers, raising the price of goods or services.

Mr. Rahn, would you comment on these noninterest conditions?

Mr. RAHN. What you've just outlined is absolutely correct. The problem with going to a system where you have all these other types of fees and conditions, is that it becomes very hard for borrowers to compare costs. Hence, you reduce the efficency of your financial markets. You get less efficient allocation of your financial resources. As a result, you can expect high rates of unemployment, lower sales and lower productivity growth.

The CHAIRMAN. Who would you expect would be harder hit by these noninterest-type of costs? What categories of borrowers?

Mr. SCHOTANUS. I think it depends a great deal on the environment. We lived with circumstances, such as you described earlier, in the State of Arkansas for many years.

We're talking about the farm and construction equipment business, but I think it depends on the state of the industry. For many years the Arkansas 10-percent usury limit was met, but again, it was because of the highly competitive equipment industry.

I think in the current environment a State with that level of interest rates would simply not get credit. That would be the response to it.

The CHAIRMAN. Or they would pay in other areas as we suggested.

Mr. SCHOTANUS. Yes; I think the important thing in our industry is the fact that we're talking about 5- and 6-year term credit, not 30-day consumer financing or 90-day consumer financing.

The problem with the State usury limits is that our competitors, the independent finance companies, are unwilling to commit at a fixed rate for 5 to 6 years, leaving less than complete competition.

VARIABLE LOAN RATES

In our own case, we're unique in that we have gone to variable rate financing because we believe we can deliver our customers credit at a much better rate.

The CHAIRMAN. How do usury ceilings affect your ability to make variable rate loans?

Mr. SCHOTANUS. There are 17 States which will inhibit that process. They would inhibit it if interest rates began to rise and approach the 18-percent level again.

Currently one can operate, but we are in this hiatus taking a risk that we would not continue to take in the long run.

For our variable rate, for example; we've chosen an easily understood rate; we're charging the customers 2 over prime, so in the farm equipment market, the customer will be able to get 12½-percent money from us including credit life and property insurance, which is worth probably 75 basis points.

The problem with State usury statutes in this regard is that many of these States attempted to emulate the Federal formula. They lifted the Federal formula, plugged it into a fixed rate statute, so that while we might be perfectly willing to lend for 5 or 6 years at 2 over prime, the way the State statute operates in many cases is to fix the initial rate as a ceiling over the life of that loan.

So, in other words if we would go in at 13½ today because that's the State formula, that would become a fixed rate obligation for 5 or 6 years, and here's where the independent finance companies seem to be unwilling to commit and to compete.

USURY CEILINGS BECOME A FLOOR

The CHAIRMAN. The claim is often made, Mr. Palmer, that once you establish a ceiling that it becomes a floor.

Do you agree with the statement that with usury ceilings in place all rates gravitate to that ceiling?

Mr. PALMER. No; I don't. I think that's a simplistic answer by people who don't face up to the free market system.

The CHAIRMAN. Certainly, 2 years ago when I was talking about credit unions, I indicated that even when the ceiling was raised to 21 percent, more than 60 percent of the loans were down in the 12 and 15 percent range. There was overwhelming evidence that had not been the case.

Mr. PALMER. Yes; I would agree.

The CHAIRMAN. Senator Hawkins.

Senator HAWKINS. Does this apply to auto loans also—automobile loans?

Is automobile loans considered a consumer interest in your mind?

Mr. PALMER. In my mind it is, yes.

Senator HAWKINS. I met with some auto dealers last week. Florida is in the process in their legislature of lifting the rates we've had for a long time. The auto dealers are gleefully waiting for that moment because they want to charge whatever the individual customer, whatever they feel the individual customer can bear even in light of GMAC coming out with 9.9, you know. In this last and latest flurry, I said, "Wouldn't that alter your plans?" And they said "No, credit is an individual thing to us and once we can get this lifted, we can charge whatever we can get the customer to sign for."

Mr. PALMER. I might point out that GM's rate came down only as an incentive to move their small cars that weren't selling.

There again, I think it defends the fact that the market will also support, you know—the market will support whatever is the relation to the goods.

I don't think removing the usury law that the customer is automatically going to pay the higher price.

Senator HAWKINS. Our hearings showed us that 40 percent of all the money in the consumer market goes for automobiles. That's the percentage that is used for autos, so it seems to me that we'll have to track it real closely, at least in my State where we lift that for the first time, and see exactly what they're charging dealer by dealer. Because there is so much confusion now with these special prices that even FTC has made special studies.

Thank you.

The CHAIRMAN. I think what has been shown is that the rebates haven't done nearly the job of selling the cars, as the incentive of lower interest rates has.

So, that doesn't sound very intelligent to me, if that's the way your auto dealers are going. My dealers in Utah are smarter than that. [Laughter.]

The CHAIRMAN. Senator Hecht, did you have any questions? You'd better come up here closer so I can see you, I don't want to miss you sitting way over there on the end.

Senator HECHT. That's OK. Thank you. I can hold my notes here.

The CHAIRMAN. Thank you very much, gentlemen.

Now, if panel No. 3 will come up: Ellen Broadman, counsel for government affairs of the Consumers Union, Glenn Nishimura, legislative representative of the Consumer Federation of America; and Henry Schechter, director, Office of Housing and Monetary Policy of the AFL-CIO.

The CHAIRMAN. Henry, before you even testify, my first question is how do you have time to ever get any work done? You're testifying so often.

Mr. SCHECHTER. We work overtime.

The CHAIRMAN. You work nights so you can come down and appear before congressional committees.

We appreciate each of you being here. Miss Broadman, would you like to begin?

STATEMENTS OF ELLEN BROADMAN, COUNSEL, GOVERNMENTAL AFFAIRS, CONSUMERS UNION; GLENN NISHIMURA, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA; AND HENRY B. SCHECHTER, DIRECTOR, OFFICE OF HOUSING AND MONETARY POLICY, AFL-CIO

Ms. Broadman. Mr. Chairman, members of the subcommittee, I appreciate this opportunity to testify on behalf of Consumers Union.

OPPOSITION TO BILL

We are in opposition to the bill and I guess express a minority view among the people who have testified thus far. In earlier testimony I've explained that we believe usury ceilings should be set above market rates but that they are needed to protect unsophisticated consumers against loan sharking and unconscionable interest rates.

We believe that the States have acted to adjust their usury laws to bring them into line with the market, and that at this point there's no need for Federal preemption of these laws.

We find that the proposed bill is overreaching and that it would preempt State laws that would prohibit unconscionable interest rates, rates of 50, 60, 80 percent. We see no justification for the Federal Government to preempt State laws that are doing nothing more than protecting consumers against unconsionable interest rates.

Today, rather than repeat earlier testimony that we've given explaining why we think usury ceilings are necessary, I would like to focus on consumer protections that we feel must accompany a bill of this sort with the caveat that we are opposed to the bill.

The first protection we would like to see included is one that requires consumer credit contracts to be written in plain English. If consumers are to protect themselves in a usury-free market, they need to be able to understand both the costs and the terms of the contracts that bind them.

We've seen several States that have adopted plain language laws that do apply to credit agreements and other areas, and we believe that enough experience has been gathered on the State level to draft a national plain language law.

The second group of protections—let me just say I'm going to summarize my testimony and in the testimony we explain in greater detail the consumer protections we want and why.

The second area that we feel there will be a need for greater consumer protection is the truth-in-lending disclosures. Again, in the no-usury market, consumers need better, more accurate and more complete information about consumer credit, about the charges and about the terms that are imposed so they can avoid unfair and undesirable credit agreements.

Under S. 730 creditors can charge virtually any kind of charge for consumer credit, including charges that would not appear in the annual percentage rate, the APR that consumers use to shop for credit. For example, with credit cards lenders can charge unlimited annual fees, transaction fees, or one-time charges that are never included in the APR, so it would be very difficult for consumers to understand what they are shopping for, what they are buying, and what they are getting into.

In our testimony we explain what additional truth-in-lending disclosures we feel would be necessary and what kinds of charges we feel should be restricted or prohibited so that consumers can use the annual percentage rate to shop and to protect themselves in the non-usury environment.

CONSUMER PROTECTION AGAINST ABUSIVE CREDITOR PRACTICES

The third category of protections we feel are needed are protections against abusive creditor practices when a consumer cannot pay.

Again if we are going to allow unlimited interest rates, unconscionable credit charges, consumers who cannot pay them should be protected against oppressive and abusive creditor practices.

The first would be a prohibition against confessions of judgment and similar contractual language that waives consumers' rights to notice and an opportunity to be heard before judgment is entered against them on default.

These provisions deprive consumers of minimal procedural due process of law. They're prohibited in most States and we feel this should be prohibited on a national level.

Wage assignments which give creditors the power to seize wages without any court hearing also should be prohibited. Instead, lenders should be required to pursue what are called garnishment procedures in which they give consumers notice and an opportunity to be heard before wages can be seized.

Again, if consumers are to be left unprotected against unconscionable credit charges, they should at least be given basic procedural due process rights before their wages and other property can be seized.

We also believe that nonpurchase money security interests in household goods should be prohibited. The Federal Trade Commission's credit practices record documents how creditors use these security interest in household goods to intimidate and threaten debtors who simply cannot pay their debts.

These are security interests that are taken in household goods to secure credit that's used to purchase other items. The household goods generally have no resale value to the creditor but have enormous psychological value to the person who owns them and who needs them—their mops, their sponges, their basic household goods—to survive.

So, when these goods are seized and sold, they discharge very little of the debt and the creditors use the threat of seizure to intimidate consumers to refinance on highly undesirable terms and to generally disrupt the lives of individuals who simply cannot pay their debts.

We also believe that blanket security interests should be prohibited. These are security interests where creditors take security in broad categories of goods rather than specific items.

If creditors are to be allowed to charge unlimited interest rates, they should at least be required to specify what goods consumers will lose if they can't meet their payments.

DEFICIENCY JUDGMENTS

We believe that these also should be regulated if usury ceilings are lifted. The uniform commercial code in effect in most states allows lenders to repossess and sell property that is secured if the consumer defaults.

If the receipts from that sale don't pay off the debt, the creditor then can go after the debtor for the remainder that's owed. Again, the Federal Trade Commission credit practices' rulemaking documents how this scheme has resulted in devastating inequities in consumer credit situations. Those repossessed consumer goods, especially low value items, are sold at inconsequential or grossly deflated prices.

Even high-value items are sold at wholesale or lower prices to creditors or creditor affiliates who then turn around and sell them at a much higher price.

However, the debtor only receives credit for the lower sales price and has to pay an unduly high deficiency judgment.

To remedy this problem we think that lenders should be required to elect between repossession and seeking a judgment on the underlying debt whenever the security does not have to establish the retail sales price. But if a retail sales price exists, then deficiency judgments should be permitted.

There's also a need for a restriction on attorney's fees. Many consumer credit contracts require the debtor to pay attorney's fees if they default regardless of whether the borrower has a valid defense to nonpayments.

These contracts are boiler plate, they're basically contracts of adhesion. Consumers cannot bargain for them and are often unaware of their liabilities.

The attorney's fees add to the distress of the borrower who already cannot meet his or her credit payments and is already facing serious financial hardship.

We feel these fees should be prohibited or regulated so that these consumers should not be required to pay attorney's fees to their creditors.

COSIGNERS NEED PROTECTION

Last, we feel that cosigners need greater protection in the nonusury environment. Cosigners are often unaware of the nature and obligations that they are assuming.

Some have thought they're merely attesting to the character or trustworthiness of the principal debtor. Others have been pressured into cosigning in highly coercive situations where family or friends have defaulted.

We believe that in order to protect cosigners, they should be given a statement explaining what their potential liabilities are before they become cosigners, so that they know what they're getting into.

We also think that where cosigners are asked to guarantee debts that are already in default in a highly pressured situation they should be given a 3-day cooling off period in order to reevaluate whether they want to make this commitment.

In conclusion, we strongly urge you to reject S. 730. We believe that this bill proposes unnecessary and harmful Federal abolition of State laws which do nothing more than protect consumers against unconscionable credit charges.

However, if you decide to nonetheless pursue what we feel is an ill-advised course, we hope you will include the basic substantive consumer protections that we've outlined in our testimony.

Thank you very much for this opportunity to testify.

[The complete statement follows:]

PREPARED STATEMENT OF ELLEN BROADMAN, COUNSEL FOR GOVERNMENT AFFAIRS, CONSUMERS UNION

Mr. Chairman and members of the subcommittee, Consumers Union [1] appreciates this opportunity to testify on S. 730. We strongly oppose this bill.

S. 730 would abolish all state laws that limit interest rates or certain other charges for consumer credit. Even state laws that allow interest rates significantly above market levels and therefore only prohibit unconscionable charges would be erased. This bill would legalize loan sharking and invite a new era of consumer abuses. CU finds the broad sweep of this bill wholly unwarranted in any circumstances, and especially now given that most states have increased their usury ceilings to keep abreast of market changes and that market interest rates are generally below usury limits.

In earlier testimony before this committee, CU explained how usury ceilings are needed to protect unsophisticated and uninformed consumers from interest charges unconscionally in excess of market rates. We also described abuses found in states where usury limits had been removed. Today, we will not repeat that testimony, but instead will focus on the consumer protections that must accompany any ill-advised federal abolition of these important state consumer protections. Historically, usury ceilings have been closely intertwined with substantive consumer protections. Where higher rates have been allowed, stricter restrictions have been placed on questionable creditor remedies; where lower rate limits have been imposed, fewer consumer protections have viewed as necessary. Underlying this trade off is an assumption that lenders that assess high interest rates can earn reasonable profits without charging additional fees or pursuing oppressive remedies on default. Where ceilings are low, lenders have been given more latitude to collect debts from defaulting borrowers and to assess charges for specific expenses.

If this web of usury limits and substantive state rights are erased, basic consumer protections are needed to protect individuals against excessive fees, especially fees that do not appear in the Annual Percentage Rate, and to protect borrowers against abusive creditor remedies on default. In particular, the unsophisticated consumer, who would be most likely to accept contracts with unconscionable credit charges, vitally needs this protection against further abuse.

I. PLAIN ENGLISH REQUIREMENTS

S. 730 should include a requirement that all covered contracts be written in plain English, using terms and phrases that borrowers can understand. To protect themselves against unconscionable credit charges, consumers must be able to understand the credit contracts that bind them. They need understandable descriptions both of charges and of the implications of nonpayment. Regarding security interests, for example, they should be clearly informed that they may lose their homes if, due to variable or steep interest rates, they cannot meet credit payments. Similarily, consumers should be informed in language they can understand that if they pay off all or part of a loan early, they will be assessed a prepayment penalty of a specified amount. Given that consumer credit may become riskier for individuals if usury limits are erased and rates are allowed to fluctuate without restraint, it is important that credit agreements also simply state what creditor remedies may be exercised on default.

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[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide information, education, and counsel about consumer goods and services and the management of the family income. Consumers Union's income is derived solely from the sale of *Consumer Reports*, its other publications, and films. Expenses of occcasional public service efforts may be met, in part, by nonrestrictive, noncommercial grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports*, with over 2.8 million circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

Altogether, in the interest of fairness, if consumers are no longer to be protected against loan sharking, at a minimum, they should be provided with credit contracts they can understand.

Several states have adopted plain language laws that apply to credit agreements, and many have such laws for other consumer contracts (e.g. insurance). Enough experience and information have been gathered to draft a national plain language law for consumer credit agreements. Consumers Union would welcome the opportunity to work with committee staff on drafting such requirements.

II. IMPROVE UTILITY OF TRUTH IN LENDING DISCLOSURES

In a no-usury market, consumers would need complete, accurate, and comparable disclosures about consumer credit charges and terms to avoid unfair or undesirable agreements. The disclosures required by the Truth in Lending Act provide some valuable assistance but, unfortunately, in many circumstances are undermined by creditor practices and would need strengthening if usury limits are erased.

Under S. 730, creditors could assess virtually any charges for consumer credit, including charges that might not be included in the annual percentage rate (APR) disclosure. For example, with credit cards, lenders could charge unlimited annual fees, transaction fees, or other one-time charges that are never factored into the APR, which consumers use to comparison shop. The utility of APR disclosures for open end credit would be further undermined by differences in the ways lenders calculate the balance to which the APR is applied and differences in the free periods given consumers who do and do not pay their entire credit card bill each month.

Also, current variable rate loans have interest rates that change in unpredictable amounts during the loan term so that APR disclosures on these loans have become an unreliable basis for estimating the cost of credit. Some lenders are taking security interests in homes for variable rate credit, so that consumers can lose their homes if they are unable to pay rate hikes.

If credit charges are totally deregulated, consumers will become dependent on TILA disclosures to protect themselves. To enable them to rely on APR, creditors should be prohibited from assessing any charges for the use of credit that do not appear in the APR. (Creditors would still be permitted to assess special charges on default). Also, the method used to compute the balances to which the APR is applied in open end lines of credit should be standardized to simplify comparisons. Clearer disclosures should be required describing free periods (e.g. "If you do not pay off your balance within the billing cycle, you will be charged interest on all subsequent purchases from the date of puchase. This may increase your finance charges significantly.") With variable rate loans, lenders should be required to disclose how much the monthly payment will increase under fixed hypothetical conditions. Under Regulation Z, creditors can disclose only nominal increases using whatever hypothetical they select. Some lenders may disclose more favorable hypotheticals then others, and consumers are likely to be confused. CU believes that all lenders should use the same hypotheticals, identified as such, perhaps one with substantial rate increases and another with decreases.

III. ELIMINATE ABUSIVE CREDITOR PRACTICES ON DEFAULT

Confessions of judgment and similair contractual language that waives consumers' right to notice and an opportunity to be heard before a judgment is entered against them on default should be prohibited. These provisions deprive consumers of minimal procedural due process of law. Most states already forbid the use of such contractual devices. If usury ceilings are abolishd so that creditors can charge interest rates previously considered unconscionable, creditors should at least be required to serve consumers who cannot meet credit payments with a complaint and to give them an opportunity to raise in court whatever defenses they may have to nonpayment.

B. Wage assignment

Wage assignments, which give creditors power to seize borrower's wages without even cursory judicial scrutiny or other procedural safeguards, should be prohibited. Instead, lenders should pursue garnishment proceedings which provide borrowers with prior notice and a hearing before an impartial decisionmaker before wages can be seized. Again, if consumers are to be left unprotected against unconscionable and unfair credit charges, they should at least be given basic due process rights to a fair hearing before their wages can be taken to pay off these loans.

C. Security interest in household goods

Non-purchase money security interests in household goods also should be prohibited. As documented in the FTC Credit Practices Rule proceedings, creditors take these security interests in household goods, essentially worthless to the creditor, to harass and threaten debtors who cannot meet credit payments. The Presiding Officer's Report at page 136 explains:

> Since the usual causes of default are for reasons beyond the control of the consumer, e.g., loss of job, abandonment by spouse, and illness, the threat to repossess household goods causes great emotional suffering, humiliation, anxiety, and deep feelings of guilt; and this distress can lead to physical breakdowns or illness, disruption of the family, and undue strain on the family relationships.

By threatening to seize household goods, creditors can coerce consumers to refinance overdue obligations on highly unfavorable terms or force some individuals into bankruptcy.

When household goods are actually seized, consumers lives are totally disrupted for minimal or no financial benefits for the creditor. While household goods may have a high psychological or sentimental value to consumers, and be costly to replace, as used goods they have very low resale value and discharge little, if any, of the debtor's obligation. As the FTC Staff Report at page 227 concluded, security interests in household goods "offer little economic return to creditors at great economic and social cost."

If usury ceilings are lifted so that unsophisticated consumers may be drawn into unduly expensive, high interest rate credit agreements, individuals should be protected against abusive creditor practices upon default. Individuals who truly cannot meet their credit payments should not be subjected to threats that essential personal possessions not purchased with the credit at issue will be seized.

Similarly, the Fair Debt Collection Practices Act should be expanded to cover debts collected by creditors and their attorneys. The law presently provides borrowers with important protections against abusive debt collection practices by debt collection agencies. Such abuses should also be proscribed when engaged in by creditors or their attorneys.

D. Blanket security interests

Some creditors take a blanket security interest in categories of goods rather than specific items, causing confusion or misunderstanding about which possessions may be seized for non-payment. If creditors are allowed to charge unlimited interest rates, they should at a minimum be required to spell out precisely which consumer items may be lost if payments cannot be met.

E. Deficiency balances

The Uniform Commercial Code, in effect in most states, allows lenders to repossess and sell secured property on default and to charge the costs of the sale to the borrower. Any amounts owed, but not paid with the receipts of the sale may be collected from the borrower. The FTC Credit Practices rulemaking record documents how this scheme has resulted in devastating inequities in consumer credit situations (see Staff Report at pages 259, 268–69). Most repossessed consumer goods, especially low value items, are sold at inconsequential or grossly deflated prices. Even high value items have been sold at wholesale or lower prices to a creditor or its affiliates which then sells the items at a much higher price. However, the debtor receives credit only for the initial low sale price and must pay a correspondingly higher deficiency balance.

To remedy this problem, lenders should be required to elect between repossession and seeking a judgment on the underlying debt, whenever the security has no established retail sale price. However, if an established retail sale price exists, deficiency judgments should be permitted.

E-1. Attorney fees

Consumer credit contracts often require borrowers to pay the lender's attorney fees if they default, regardless of whether the borrower has a valid defense to nonpayment. These clauses are boilerplate in contracts of adhesion. Consumers do not bargain for them and often are unaware of the liabilities they would assume. Attorneys fees add to the distress of consumers who are already facing financial hardship and are used for *in terrorem* purposes. Creditors have threatened to recover high fee awards to force borrowers with legitimate defenses into unfavorable settlements.

These clauses provide little financial gain for creditors, who rarely can collect those fees anyway and who use low cost, assembly-line procedures to secure most deficiency judgments. (see Staff Report at 333–49). If usury limits are erased, individuals who cannot meet payments should be protected against the assessment of attorneys fees as well.

F. Cosigners

Cosigners ofter are unaware of the nature and extent of their liability. Some have thought they were merely attesting to the character or trustworthiness of the principal debtor. Others have been pressured into cosigning in highly coercive situations when family or friends have defaulted. Creditors have threatened to repossess property and sue unless the borrower finds a cosigner. In this pressured situation, neither the lender nor borrower have an incentive to inform cosigners of their obligations. (see Staff Report at pages 437–47).

In order to protect cosigners, who generally receive little if any benefit for assuming substantial liabilities, lenders should be required to furnish them with a statement explaining their potential liabilities before they sign a contract. Also, individuals who are asked to guarantee debts already in default should be given a three day "cooling off" period to make an unpressured and informed choice to accept or reject cosigner liabilities.

CONCLUSION

In conclusion, we strongly urge you to reject S. 730, a bill that proposes an unnecessary and harmful federal intrusion into an area regulated by state law. We perceive of no justification for federal abolition of state laws, such as laws imposing interest rate ceilings of 45 percent or more, that do nothing more than protect consumers against unconscionable credit charges. However, if the committee decides to pursue this ill-advised course, we hope that you will include the basic substantive consumer protections we have outlined in our testimony.

The CHAIRMAN. Mr. Nishimura.

GLENN NISHIMURA, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA

Mr. NISHIMURA. Mr. Chairman, members of the committee, I'm Glenn Nishimura, legislative representative for the Consumer Federation of America.

The Consumer Federation appreciates the opportunity to testify on S. 730, a bill to eliminate State usury ceilings which, as Governor Partee pointed out in the first panel, are designed to protect the highest risk and most vulnerable group of borrowers.

S. 730 would cost borrowers billions of additional finance charges and allow lenders to impose a variety of extra fees that would make comparison shopping for loans difficult if not impossible.

And though a chief motivation behind S. 730 is the desire to expand credit availability, we believe that this goal is not likely to result from the passage of this bill.

INTEREST RATES HISTORICALLY HIGH

Hearings held last month by the Consumer Subcommittee, under the able leadership of Senator Hawkins of this committee, demonstrated that real interest rates are at historical highs.

Consumers justifiably wonder why. So have the President and the Secretary of the Treasury. Against this backdrop, this committee is today considering a bill that promises to mean even higher rates for consumers across the country.

With over $340 billion in outstanding consumer installment credits, a 1-percent rise in the APR will translate into $3½ million from borrowers to lenders.

Aside from being highly inflationary, this would jeopardize any rapid economic recovery. But the full impact of S. 730 is much more than unbridled interest rates.

S. 730 would render the credit market undecipherable to consumers. It would prohibit State regulation of almost every aspect of consumer financial transactions.

No matter how predatory, no matter how unfair, no matter how widespread a lending practice may be, practically any loan for any rate of interest under any terms would be legal.

Such sweeping change fails to take into account the fact that States have fashioned their credit laws to balance lender needs with consumer protection.

S. 730 would nullify hundreds of acts of State legislative discretion in one fell swoop.

In doing so, it would legalize loansharking, and put the Government stamp of approval on deceptive practices.

Ironically, the consumer credit market is already moving beyond the comprehension of even the more sophisticated borrower.

Dramatic changes have made comparison shopping more difficult, and when comparison shopping becomes more difficult, competition suffers.

S. 730 would allow many charges to go unreflected by the APR, making comparisons impossible. Congress should be moving to create more, not less, order in the market.

In 1982, 38 States made changes in their finance laws that affect consumers. Already in 1983, controversial bills have been debated in States such as New York, Maryland, Florida, and Connecticut.

The process is working as it should, and Federal intervention is unwarranted. Consider the case of Arkansas, the State which I lived in for a long time.

In 1982, Arkansas voters approved an increase in the allowable consumer interest rates to 17 percent, amending their much maligned and infamous 10 percent ceiling.

The Arkansas experience, though, is a perfect example of consumers negotiating with lenders in order to maintain consumer protections.

In 1974 and again in 1980, lenders not only wanted higher usury ceilings, they wanted more latitude in defining the term "interest," and more lenient usury penalties.

But Arkansans said no. They voted against having a wide variety of rates. They voted down confusing definitions of interest. They rejected ineffective penalties for unlawful lending.

Now, the usury limit since the election in 1982 in Arkansas is 17 percent on consumer loans. Interest is strictly defined still, and the penalty for usury is still considerable.

S. 730 would wipe out all that Arkansans have fought to preserve. Rather than passing S. 730, Congress should consider the real strides in fostering competition that would be achieved by requiring strict definition of interest, as Arkansas has done.

STRICT UNIFORM DEFINITION OF INTEREST

A strict and uniform definition of interest would give consumers more confidence in comparisons in the marketplace while shopping for credit.

Moreover, Congress should consider imposing penalties that place the burden of compliance on the lender, thereby making usury law self-enforcing.

Lenders argue that consumer rates would be kept reasonable because of vigorous competition in credit markets. This is a dangerous assumption. Some lending markets clearly are not competitive, and competition in the credit market is not like competition in the supermarket. Much more is at stake, since consumers could lose their homes and their life savings.

The transaction is infinitely more complex. In particular, this complexity befuddles the low-income and unsophisticated borrower. And they will be the targets of the unscrupulous lenders that S. 730 will unleash.

There's documented evidence showing inner city Chicago used car buyers paying up to 50 percent interest and D.C. consumers being charged up to 80 percent on second-mortgage loan scams.

Exorbitant consumer rates prey on those who are least able to afford them. Reasonable ceilings appropriately protect the unsophisticated borrower from credit gouging.

One argument for S. 730 is that higher allowed interest rates would make more credit available to high-risk individuals.

But a New York Banking Department study offers evidence to the contrary.

The study reports on market changes since the State raised its usury ceilings to 25 percent. For commercial banks, only 7 percent liberalized loan standards. Only 17 percent raised their maximum lines of credit.

For savings banks, savings and loan associations, credit unions, licensed lenders, retailers, and auto dealers, all treated separately, the study makes clear that very little change has occurred in credit standards and lines of credit.

What conclusion do we draw from this? Consumers who are eligible for credit at 25 percent are the same consumers who are eligible for credit at 18 percent.

Higher interest rates have not made credit available to high-risk borrowers, but they have increased the earnings of lenders.

As credit markets are deregulated, consumers are becoming less able to make intelligent choices. S. 730 would exacerbate the problem.

Instead of pursuing this bill, Congress should investigate ways to provide consumers with more credit information and protection.

The CFA offers its assistance in fashioning such legislation.

Thank you, Senator.

The CHAIRMAN. Thank you.

[The complete statement follows:]

PREPARED STATEMENT OF GLENN NISHIMURA, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA

Mr. Chairman and members of the committee, I am Glenn Nishimura, Legislative Representative for Consumer Federal of America (CFA), a coalition of over 200 national, state and local consumer, senior citizen, labor, farm, cooperative and rural organizations which together represent more than 35 million people.

CFA appreciates the opportunity to testify on S. 730, a bill to eliminate state usury ceilings that are designed to protect the highest risk and most vulnerable group of borrowers. We have testified in past sessions of Congress before committees of both chambers on identical legislation. CFA remains strongly opposed to federal preemption of state usury ceilings and the accompanying federal prohibition of state efforts to protect its own residents.

S. 730 would cost borrowers billions in additional finance charges and allow lenders to impose a variety of extra fees that would make comparision shopping for loans difficult, if not impossible. And, although a chief motivation behind S. 730 is a desire to expand credit availability, we believe that this goal is not likely to result from the passage of this bill.

CONSUMER INTEREST RATES ARE ALREADY TOO HIGH

Hearings held last month by the Consumer Subcommittee of this Committee demonstrated that real interest rates are at historical highs. Over the past year interest rates have failed to track the falling inflation rate, producing real rates 2 to 3 times their traditional levels. Consumers justifiably wonder why. So have the President and the Secretary of the Treasury.

Against this backdrop, this Committee is today considering a bill that promises to mean even higher interest rates for consumers across the country. New Jersey presents a case in point. New Jersey usury ceilings were lifted in 1981 allowing finance companies to charge up to 30 percent for loans. The state average for these types of loans had been at the national average of about 21 percent. As soon as the new law became effective, these rates shot up 6–7 percent and have stayed at that high level. There is no doubt that, when the lid is taken off, interest rates will shoot upward. With over $340 billion in outstanding consumer installment credit, every one percent rise in the average APR will transfer nearly $3½ billion from borrowers to lenders. Aside from being highly inflationary, such increases would seriously jeopardize any hopes for rapid economic recovery. But, the full impact of S. 730 is much more than unbridled interest rate increases.

S. 730 WOULD RENDER THE CREDIT MARKET UNDECIPHERABLE TO CONSUMERS

S. 730 would prohibit state regulation of almost every aspect of consumer financial transactions. No matter how predatory, no matter how unfair, and no matter how widespread a lending practice may be, any loan for any rate of interest under any terms would be legal. Such sweeping change fails to take into account the fact that states have fashioned their credit laws to balance lender needs with consumer protections. State action in this area is a result of identified abuses in the credit market. S. 730 would deny that those abuses are serious, that consumers need some protections and that it is the proper role of the states to provide those protections.

There are numerous restraints on fees and charges arising out of consumer credit transactions that will be wiped out by S. 730. For example, some states prohibit prepayment penalty charges and require rebate of unearned finance charges. Other state laws govern closing costs, insurance charges, down payments, balloon payments, deferral charges and more. In each instance of state law, local lawmakers have recognized credit abuse or potential credit abuse and have acted to prohibit or control such activities. S. 730 would nullify hundreds of acts of state legislative discretion in one fell swoop. In doing so, S. 730 would place consumers in jeopardy of being victimized by unscrupulous lenders. It would legalize loan sharking and put the government stamp of approval on deceptive practices.

Ironically, the consumer credit market is already moving beyond the comprehension of even the more sophisticated borrower. Variable rate mortgages, equity loans, and debit cards are only a few of the indications of a rapidly changing credit environment. These and other changes have made comparison shopping more difficult. And, when comparison shopping becomes more difficult, competition suffers. S. 730 would cause a quantum leap in the problem. By preempting state ability to regulate credit transactions, S. 730 would allow a variety of extra fees and charges that will not be reflected by the APR. Consumers will find comparison shopping impossible. Congress should be moving toward creating more, not less, order in the market.

STATES HAVE BEEN ACTIVE

In 1982, the Consumer Finance Newsletter reported that 38 states had made changes in their finance laws that affect consumers. This extraordinarily high figure demonstrates that states are constantly reviewing their usury laws and making appropriate adjustments. Appendix A shows how allowable interest rates have increased. Often state approval of higher interest ceilings or increased fees are coupled with additional consumer protections. S. 730 would discourage the meaningful public discussion that accompanies consideration of such state legislation.

Already in 1983, controversial bills have been debated in states such as New York, Maryland, Florida, and Connecticut. The process is working as it should, and federal intervention is unwarranted.

In Maryland, consumer lending laws have been the central issue in recent legislative sessions. The usury ceiling was lifted to 24% in 1982. This year, the legislature has considered allowing lenders to impose fees and charges that have traditionally been prohibited. During the course of the debate in the Maryland House, at least 23 consumer amendments were offered. Most were rejected. The bill appears to be headed for enactment. CFA believes that Maryland consumers will be worse off because of this bill. However, the issue was fully aired in the legislature and the press. Consumer oriented legislators had the opportunity to attempt to balance the proposal. Maryland voters will have a chance to express their disapproval at the next election. S. 730 would nullify the discussion, the legislative process, and accountability to voters.

On the other end of the spectrum, consider the case of Arkansas. In 1982, Arkansas voters approved an increase in allowable consumer interest rates to 17 percent, amending their much maligned and infamous 10 percent usury ceiling. Many believe only that Arkansans had finally come to their senses, but, in fact, the Arkansas experience is a perfect example of consumers negotiating with lenders in order to maintain consumer protections. Those consumer protections, both before the 1982 vote and still today, are probably the strongest in the country.

When lenders tried in 1974 and again in 1980, to change the usury laws, they wanted not only higher ceilings but also more latitude in defining interest and more leniency in penalties for illegal lending. But Arkansans said, "No." They voted against having a wide variety of rates. They voted down confusing and incomplete definitions of interest. They rejected meaningless and ineffective penalties for unlawful lending.

Now, the usury limit in Arkansas is 17 percent on consumer loans, practically anything that is not principal is considered interest, and the penalty for usurious lending is loss of interest and principal. S. 730 would wipe out all that Arkansans fought to preserve.

If Congress is open to preempting state regulation of consumer credit transactions, it should reject the concept embodied in S. 730 and consider the real strides in fostering competition that would be achieved by requiring strict definition of interest as Arkansas has done. A strict and uniform definition of interest would give consumers more confidence in comparison shopping for credit. Moreover, Congress should consider imposing penalties that place the burden of compliance on the lender, thereby making usury laws self enforcing.

CREDIT MARKETPLACE IS NOT COMPETITIVE

Lenders argue that consumer rates would be kept reasonable because of vigorous competition in credit markets. This is a dangerous assumption. While some lending markets may be somewhat competitive, others clearly are not competitive. A survey by the New York Banking Department showed that most licensed lenders in the state were charging the legal maximum for car loans and personal loans, both secured and unsecured. On these loans, competition between these lenders is virtually nonexistent.

From a consumer perspective, competition in the credit market is not like competition in the supermarket. In both cases an informed consumer is the key to a competitive market. But when pricing goods, the cost to the consumer is usually clearly marked on the item and readily comparable. In buying credit, much more is at stake since consumers could lose their homes and life savings. Moreover, the transaction is infinitely more complicated.

This complexity in particular befuddles the low income and unsophisticated borrower. And they will be the target of the unscrupulous lenders that S. 730 will unleash.

Documented evidence of some inner city Chicago used car buyers paying 50 percent interest and D.C. consumers being charged up to 80 percent on second mortgage loans scams bears this out.

Exorbitant consumer rates prey on those who are least able to afford them. Reasonable usury ceilings appropriate protect the relatively unsophisticated borrower from credit gouging.

In testimony before the House Small Business Subcommittee in 1980, Lewis Odom, Senior Deputy Comptroller of the Currency said:

We must be mindful of the legitimate concern for the small, financially weak borrower who may fall prey to disreputable lending practices. In those parts of the country where credit markets are yet reasonably competitive, there is a pressing need for minimum safeguards to protect the rights of the most vulnerable.

Mr. Odom's analysis is supported by the Federal Reserve Board's 1977 Consumer Credit Survey. The survey revealed aspects of loan demand which worked to lessen competition, noting that only 30 percent of potential borrowers shop for loans and that most choose lenders based primarily on proximity and familiarity. Finally, the largest study of this market, undertaken by the National Commission on Consumer Finance, recognized structural features of the consumer lending industry which weakened competition. NCCF therefore found it necessary to couple its rate ceiling recommendations with extensive consumer protection proposals.

In stark contract, S. 730 contains no consumer safeguards. In fact, it would act to prohibit such safeguards. The legislation would allow total interest rate preemption even in those states which traditionally have chosen to protect borrowers through low rates instead of through consumer protection statutes.

BANKRUPTCIES HIGHER IN HIGH INTEREST RATE STATES

In addition to higher finance charges, borrowers are likely to pay for S. 730 in another way: increased bankruptcies. Available data show that, as average interest rates rise, personal bankruptcy rates follow. An analysis conducted by CFA using 1979 data revealed a significant difference in rates of bankruptcies between states with high rates and those with low rates. With the allowable rates charged on a $2,500, 12-month loan as a yardstick, the CFA showed that states above the average on these types of loans experienced a bankruptcy rate 19.3 percent greater than states with consumer interest rates below that average.

An update of that analysis using 1982 figures reconfirms findings. The states above the 24 percent median in Appendix A registered a rate of bankruptcy 21 percent higher than the states below the median.

	Bankruptcies/100,000
High interest rate states	185.66
Low interest rate states	153.45

NO EVIDENCE THAT CREDIT WOULD BE MORE AVAILABLE

One argument for S. 730 is that higher allowable interest rates would make more credit available to higher risk individuals. However, a study included in the report of the National Commission on Consumer Finance acknowledged a lack of clear-cut evidence that rate ceilings are significantly related to credit availability.[1] This finding is confirmed by evidence from a 1981 study at the Credit Research Center of Purdue University. The Purdue study, by Richard L. Peterson and Gregory A. Falls, examined the empirical evidence regarding the impact of Arkansas' ten percent rate ceiling.[2] Its conclusions bear importantly on S. 730. Consumers in Arkansas actually held as much consumer debt in 1979 as consumers in Louisiana (31.08 percent APR ceiling), Illinois (16.73 percent APR ceiling) and Wisconsin (16.82 percent) APR ceiling).

Of even more interest, two of the three lowest income classes in Arkansas held more debt on average than did the consumers with equivalent incomes in Louisiana, Wisconsin and Illinois. The study concludes that: Overall, the data . . . do not support the hypothesis that credit is less readily available in Arkansas than in other credit markets—and they are particularly inconsistent with the hypothesis that low income borrowers receive less credit in Arkansas. (p. 22)

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[1] Robert P. Shay, *The Impact of State Legal Rate Ceilings Upon the Availability and Price of Consumer Installment Credit,* National Commission on Consumer Finance, Volume IV, 1974.

[2] "Impact of a Ten Percent Usury Ceiling: Empirical Evidence," Working Paper Number 40, Credit Research Center, Purdue University, 1981.

Accordingly, even in the worst case, in the state of Arkansas, empirical data demonstrates that credit is available in rough proportion to its availability elsewhere.

Recently, the New York Banking Department study released in December, 1982, offers more evidence of a different kind. This study and its companion study of February 1981, reported on the changes in New York state since November 1980, when the state raised its usury ceiling to 25 percent.

While CFA has problems with the methodology and objectivity of the studies, some findings are surprisingly enlightening. The data on increased consumer lending is clouded by the provisions of the New York bill that allowed new lending powers to various financial institutions. Yet, the admissions of the study in regard to liberalized standards and larger credit lines bear recounting.

For commercial banks the studies reveal that only 7 percent of the respondents liberalized consumer loan standards and 17 percent raised their maximum lines of credit. For the other categories of lender surveyed—savings banks, savings and loan associations, credit unions, licensed lenders, retailers, and auto dealers—the study makes clear that very little change in credit standards and lines of credit has occurred.

Consequently, consumers who are eligible for credit at 25 percent are the same consumers who were eligible for credit at 18 percent. Higher interest rates have not made credit available to high risk borrowers, they have only increased earnings of lenders.

CONCLUSION

S. 730 is a costly and deceptive piece of legislation. It would not only lift all interest ceilings, but, by prohibiting state action on almost all aspects of the credit transaction, it would create a credit market that will be beyond the comprehension of virtually all borrowers. While making credit shopping almost impossible, S. 730 is unlikely to expand the supply of credit in any signifiant way.

As credit markets are deregulated, consumers are becoming less able to make intelligent choices. S. 730 would exacerbate the problem. Instead of pursuing this bill, Congress should investigate ways to provide consumers with more credit information and protection. CFA offers its assistance in fashioning such legislation.

APPENDIX A.—COMPARISON OF CONSUMER LOAN ANNUAL PERCENTAGE RATES

[Based on $2,500 loan to be repaid in twelve equal monthly installments]

1979		1982	
State	APR	State	APR
Mississippi	33.18	Arizona	(1)
Louisiana	31.08	Delaware	(1)
Georgia	27.79	Illinois	(1)
Utah	25.67	Montana	(1)
Idaho	25.67	Nevada	(1)
Washington	24.69	New Hampshire	(1)
Indiana	24.36	North Dakota	(1)
Hawaii	24.28	Oregon	(1)
Tennessee	24.00	Virginia	(1)
Rhode Island	23.99	New Mexico	45.00
Alaska	23.54	Louisiana	33.87
Florida	22.80	Mississippi	33.51
Kansas	22.65	Georgia	32.31
Maine	22.17	New Jersey	30.00
Delaware	22.08	West Virginia	29.64
New Jersey	21.89	Idaho	28.88
South Dakota	21.71	Hawaii	28.80
Colorado	21.70	Utah	27.17
Wyoming	21 70	Colorado	26.82
Oregon	21.70	Indiana	25.67
South Carolina	21.70	New York	25.00
Nevada	21.70	Ohio	25.00
Arizona	21.68	Washington	24.69
Montana	21.60	Massachusetts	24.37
Maryland	21.00	Tennessee	24.00
Ohio	20.93	Texas	24.00

APPENDIX A.—COMPARISON OF CONSUMER LOAN ANNUAL PERCENTAGE RATES—Continued

[Based on $2,500 loan to be repaid in twelve equal monthly installments]

1979		1982	
State	APR	State	APR
Iowa	20.85	Rhode Island	23.99
Oklahoma	20.47	South Dakota	23.78
Pennsylvania	19.99	Kansas	23.73
Massachusetts	19.05	Florida	23.59
Michigan	19.01	Maine	23.56
Nebraska	18.88	Oklahoma	23.56
Minnesota	18.73	Alaska	23.54
New York	18.33	South Carolina	23.35
California	18.00	North Carolina	23.20
New Hampshire	18.00	Maryland	23.01
North Dakota	18.00	Wisconsin	23.00
Virginia	17.97	Minnesota	22.31
Wisconsin	16.82	Connecticut	22.22
Illinois	16.73	Wyoming	21.70
Kentucky	16.64	Nebraska	21.60
Texas	16.57	California	21.40
New Mexico	16.38	District of Columbia	21.00
West Virginia	15.72	Iowa	21.00
Missouri	15.59	Missouri	20.84
North Carolina	15.00	Pennsylvania	19.99
Alabama	14.45	Alabama	19.89
Connecticut	12.67	Vermont	19.26
Vermont	11.58	Michigan	19.01
District of Columbia	11.60	Kentucky	18.73
Arkansas	10.00	Arkansas	10.00
Median	20.93	Median	24.00

[1] No limit.

Source.—Cost of Personal Borrowing in the United States, 1979 and 1982 editions.

Note.—Prepared by the Consumer Federation of America.

The CHAIRMAN. Mr. Schechter?

HENRY B. SCHECHTER, DIRECTOR, OFFICE OF HOUSING AND MONETARY POLICY, AFL-CIO

Mr. SCHECHTER. Mr. Chairman and members of the committee, I appreciate the opportunity to present the views of the AFL-CIO on S. 730.

The AFL-CIO is opposed to S. 730 because it would eliminate that degree of protection against exorbitant rates which consumers derive from their State laws, and would lead to weaker State protection against abusive practices.

Furthermore, in a less competitive sphere than other types of borrowers, consumers bear the brunt of upward interest rate volatility.

That will be a more frequent problem in the wake of recent financial deregulation and household investor behavior.

A tool is needed to deal with that problem for the sake of the consumer and the economy, rather than more deregulation.

The experience during the 3 years since the 1980 Federal interest rate preemption in the business loan and mortgage loan sectors has shown that interest rate ceilings are a scapegoat.

PROBLEMS IN BUSINESS AND HOUSING HIGH INTEREST RATES

The real cause of problems in the business and housing sectors was not interest rate ceilings, but the high level of interest rates.

That is confirmed by the continued high levels of business failures, home mortgage foreclosures, financial institution failures, and related unemployment.

As other interest rates declined from high levels after mid-1982, including the rates paid for money by lenders, the decline in consumer credit rates was much slower and much less, to the disadvantage of consumer borrowers.

As stated by Assistant Treasury Secretary Johnson at a hearing of the Consumer Affairs Subcommittee that was chaired by Senator Hawkins on March 17, 1983, "Consumer interest rates are generally considered to be administered rates."

At that hearing, the distinguished ranking minority member of this committee told the Government witnesses that they had not provided him with a satisfactory explanation of why consumer loan interest rates had declined far less than other interest rates.

The answer probably lies partly in the restricted market in which the consumer borrower shops for credit—generally in his immediate neighborhood or town, and perhaps only at his institution of deposit.

Furthermore, large banks such as Citicorp, with 220 branches in New York City, are a large local market influence.

Lenders, therefore, don't have to respond quickly on consumer rates when market forces are reducing interest rates and can respond quickly when they are rising.

State usury ceilings and related protective rules against excessive charges and certain collection practices have been relaxed frequently by State legislatures under pressures from lenders.

Nevertheless, the need for such changes to go through the legislative process often causes the changes to be less disadvantageous to consumers than originally proposed, and as they would be in the absence of a State's capability to establish ceilings.

There have been difficulties with State usury laws because of the differences between States, tending to cause outflows of funds from one State to a neighboring State, with high usury rate ceilings.

That problem could be overcome in large measure by the establishment of reasonable Federal usury ceilings, within which there might be State variations.

That has been done up to now in connection with business and agricultural loans. And since the Congress has taken the responsibility for doing away with any controls or wishes to take the responsibility of doing away with any controls at the State level, I would suggest it should take the responsibility for establishing reasonable ceilings at a Federal level.

Then we would not have the problem of differences in State ceilings, and the outflow of funds from one State to another.

LEAST QUALIFIED BORROWER BECOMES LESS QUALIFIED

Also, the proponents of S. 730 have raised the issue of the least qualified borrower among consumers, who presumably would be helped by higher rates because more credit would then be available.

But the least qualified borrower becomes even less qualified when interest rates are raised, because his capability of meeting the repayment of the same amount of debt is then even less.

So, I can't see how it could possibly help the least qualified buyer. A sustained economic recovery requiring high levels of housing starts, auto sales, and total retail sales, would require further reductions of interest rates.

That appears to be unlikely, however, given the circumstances of (1), the tremendous inflow of funds to money market and super NOW accounts at depository institutions, foreshadowing continued strong competition for funds among investment intermediaries and the high cost of funds to them; and (2), the continued reliance upon the Federal Reserve's limited monetary policy tool.

What we have seen in recent months is not something which was recently brand new. Ever since the 1959 so-called magic 5s, when Treasury issued 5 percent notes and people drew money out of savings accounts to buy them.

INCREASING INVESTMENT IN SECURITIES BY HOUSEHOLDS

We have had a development of increasing investment in securities by households, and over those 25 years or so, as households had higher incomes, grew more affluent, especially the upper income groups, and more economically literate, every time we got a high-interest rate period, we have a tremendous increase in direct investments by households.

Now, the money market funds came along and facilitated that. And now we have the money market accounts further facilitating it.

So, at the moment, we have half-a-trillion dollars in those accounts in depository institutions and money market funds.

Those are what we used to call hot money. And they will pursue the higher yields even more avidly than before. Which will mean much more volatility, especially on the upward side, when we hit a period of rising interest rates.

It will not be possible when the economy heats up to really get a sustained recovery, because we will have more and more competition among the intermediaries to get that money, and the money will flow quickly from one channel to another.

So, that it becomes more of a problem to try to control and have a more stable economy than we ever had before. Household investors, with their sensitivity to high yields and capability to shift funds, will force the intermediary depository institutions to compete more fiercely through high-interest payments on the savings.

The higher costs of money than in prior decades will increasingly cause the institutional lenders to seek higher returns.

To the extent that economic recovery develops, it is bound to increase credit demands, which will increase interest rates and the growth rate of the money supply.

Fears of too rapid expansion of the economy and rekindled inflation would then cause the Fed to be increasingly restrictive in its monetary policy, reinforcing the market forces that produce higher interest rates.

We will then go through the same sort of cyclical experience that we've had in the last few years. In order to have a tool that can be used in our economy of the 1980s to achieve steadier growth without great volatility of interest rates and related prolonged periods of high unemployment, authority for credit controls should be restored.

[The complete statement follows:]

Statement of Henry B. Schechter, Director, Office of Housing and Monetary Policy, American Federation of Labor and Congress of Industrial Organizations

SUMMARY

I appreciate this opportunity to present the views of the AFL-CIO on S. 730. The bill would preempt all state consumer credit usury laws and eliminate the present federal interest rate limitation on business and agricultural loans. The AFL-CIO is opposed to S. 730 because it would eliminate that degree of protection against exorbitant rates which consumers derive under state laws and would lead to weaker state protection against abusive practices. Furthermore, while in a less competitive sphere than other types of credit extension, consumers bear the brunt of upward interest rate volatility, as does the entire economy, and that will be a more frequent problem in the wake of recent financial deregulation and household investor behavior. A tool is needed to deal with that problem for the sake of the consumer and the economy, rather than more deregulation.

Experience during the three years since the 1980 federal interest rate preemption in the business loan and mortgage loan sectors has shown that interest rate ceilings are a scapegoat. The real cause of problems in the business and housing sectors was not interest rate ceilings but the high level of interest rates. That is confirmed by the continued high levels of business failures, home mortgage foreclosures, financial institution failures, and unemployment.

As other interest rates declined from high levels after mid-1982, including the rates paid for money by lenders, the decline in consumer credit rates was much slower and much less, to the disadvantage of consumer borrowers. As stated by Assistant Treasury Secretary Manual Johnson, at a hearing of the Consumer Affairs Subcommittee of this Committee on March 17, 1983: "Consumer loan rates are generally considered to be administered rates."

At that hearing, the distinguished ranking minority member of this Committee told the Government witnesses that they had not provided him with a satisfactory answer why consumer loan interest rates had declined far less than other interest rates.

The answer probably lies in part in the restricted market in which the consumer borrower shops for credit, generally in his immediate neighborhood or town, and perhaps only at his institution of deposit. Furthermore, large banks, such as Citicorp with 220 branches in New York City, are a large local market influence. Lenders, therefore, don't have to respond quickly on consumer rates when market forces are reducing interest rates and can respond quickly when they are rising.

State usury ceilings and related protective rules against excessive charges and certain collection practices have been relaxed frequently by state legislatures under pressure from lenders. Nevertheless, the need for such changes to go through the legislative process often causes the changes to be less disadvantageous to consumers than originally proposed and as they would be in the absence of the states' capability to establish ceilings. There have been difficulties with state usury laws because of the differences between states, tending to cause outflows of funds from one state to a neighboring state with higher usury rate ceilings. That problem could be overcome in large measure by the establishment of reasonable federal usury ceilings, within which there might be state variations.

A sustained economic recovery—requiring high levels of housing starts, auto sales, and total retail sales—will require further reductions of interest rates. That appears to be unlikely, however, given the following circumstances: (1) The tremendous inflow of funds to money market and super NOW accounts at depository institutions, as well as the remaining large total of such fluid short term money in money market funds, foreshadowing continued strong competition for funds among investment intermediaries and a high cost of funds to them; and, (2) the continued reliance upon the Federal Reserve limited monetary policy tool.

Household investors, with their sensitivity to high yields and capability to shift funds from one channel of investment to another, will force the intermediary depository institutions to compete even more fiercely, through higher interest payments to the household investor-savers. The higher costs of money than in prior decades will increasingly cause the institutional lenders to seek higher returns.

To the extent that economic recovery develops, it is bound to increase credit demands, which will bring increases in interest rates and in the growth rate of the money supply. Fears of a too rapid expansion of the economy and rekindled inflation would then cause the "Fed" to become increasingly restrictive in its monetary policy, reinforcing the market forces that produce higher interest rates.

In order to have a tool that can be used in our economy of the 1980s, to achieve steadier growth without great volatility of interest rates and related prolonged periods of high unemployment, authority for credit controls should be restored.

The bill S. 730 would preempt all state usury laws in connection with extensions of consumer credit made by a creditor. There would also be elimination of the present federal rate limitation on business and agricultural loans—of 5 percent over the Federal Reserve discount rate, including any surcharges then in effect. That ceiling was enacted as part of federal preemption of state usury ceilings on business and agricultural loans in the Depository Institutions Deregulation Act which also preempted state usury ceilings on residential mortgage loans, effective March 31, 1980.

Experience during the three years since the 1980 federal interest rate premption in the business loan and mortgage loan sectors has shown that interest rate ceilings are a scapegoat. The real cause of problems in the business and housing sectors was not interest rate ceilings but the high level of interest rates. In 1979, the pre-preemption period, there were 7,564 business failures, according to Dun and Bradstreet. In the next three years—the post preemption period—the number of business failures climbed to 11,742; 16,794; and 25,346. In 1982, the number of business failures was over three times as many as in 1979. Through March 25th of this year, the number of business failures is 36 percent above the comparable period of 1982. Required contractual high debt service payments continue to take their toll.

Adverse effects of high mortgage interest rates were reflected in the level of housing starts, which had been at levels of 2 million and 1.7 million in 1979 and 1980, respectively. In the three following years, in which Federal preemption of state mortgage usury ceilings were effective, annual housing starts were at levels of 1.3 million in 1980 and 1.1 million in 1981 and 1982. Thus far, this year there has been an upturn in housing starts after mortgage interest rates declined significantly, but a high level of foreclosures of homes financed in prior years continues. The interest rate sensitive auto industry also suffered. Total new domestic car sales, including those of foreign as well as U.S. make, had been 9.2 million in 1978 and 8.2 million in 1979 but fell in the next three years to 6.6, 5.2 and 5.7 million.

The experience of the housing, auto, and business sectors following the removal of state interest rate ceilings illustrates that high interest rates, rather than ceilings, exert a significantly adverse economic impact. The removal of interest rate ceilings, at a time of large demands for funds for mergers and foreign loans, facilitated the ratcheting up of interest rates to destructively high levels. Phased deregulation of limits on interest rates payable on household deposits brought competitive increases in the rates that lenders had to pay for money. There were great pressures for higher consumer interest rates, and many states changed their consumer interest rate ceilings in recent years, including 23 in 1982.

The spread of consumer interest rates over other loan rates has been increasing. Over the year ending with April 1982, rates representing the cost of funds to banks—the federal funds rate increased by about 1 percentage point and the rate of 6-month CDs declined by about four-tenths of 1 percentage point. However, rates charged by large banks on unsecured personal loans rose by between 1 and 5 percentage points.

From April 1982 to April 1983, the federal funds rate declined by 7 percentage points, and the rate on 6-month CDs by 4½ percentage points. The prime loan rate was reduced 6 percentage points. However, a Federal Reserve survey of finance rates on consumer installment loans at over 200 commercial banks showed that the decline in rates has been modest. The rate on 24-month personal loans at banks has declined slowly from 19.2 percent in November 1981 to 17.6 percent in February 1983, or by 1.6 percentage points. Rates on commercial bank credit card plans actually increased. The average credit card plan rates rose by .85 of 1 percentage point from 18.04 percent in November 1981 to almost 19 percent in February 1983. The interest rate spread widened adversely for consumers, who have less bargaining power than big business borrowers.

It is apparent from the data that consumer interest rates do not respond to competitive market forces—on the downside—as do interest rates on other loans. As stated by Assistant Treasury Secretary Manual Johnson, at a hearing of the Consumer Affairs Subcommittee of this Committee on March 17, 1983:

"Consumer loan rates are generally considered to be administered rates. That is, they are posted by lenders rather than set by the market interaction of supply and demand conditions, such as those on Treasury securities, corporate bonds, and the like. Still, even posted consumer rates must fundamentally reflect competitive forces, especially among lending institutions. (It might be noted that there is substantial regional variation in rates, reflecting local demand conditions.)"

At that hearing, the distinguished ranking minority member of this Committee told the Government witnesses that they had not provided him with a satisfactory answer why consumer loan interest rates had declined far less than other interest rates; in answer to a question whether there wasn't a lot of price leadership involved, Assistant Secretary Johnson answered that an argument can be made, but he and other government witnesses claimed that there was a lag and consumer rates would come down.

It is not only a matter of price leadership, but the different character of the consumer credit market than the market, for example, for prime business loans. The large corporate borrower is not confined to the banks in his local market; in fact, large banks from different market areas will compete for his loan business, tending to reduce the rate as their money costs come down. On the other hand, the consumer credit borrower is almost invariably restricted to his own home-town market and often restricts himself to the one institution in which he has an account. Add to that the fact that in many large urban areas, or even within a whole state, one or several large banks have dozens or even hundreds of branches. Citibank in New York, for example, recently ran a full page newspaper ad about its 220 banking locations giving money market account depositors 24 hours a day access to their funds. That pattern is increasing, with mergers and takeovers involving the same or different types of depository institutions, in more than one local market and even in more than one state. Increasingly, large depository institutions have large numbers of household depositors who will come to them for credit, whether for a loan or an open-end account, in a sense providing a semicaptive market of consumer borrowers.

The large, multi-branch institutions, therefore, are not under great competitive pressure to lower consumer credit interest rates, as they may be in connection with other types of credit. They can take advantage, when their costs of money decline, to increase their earnings on consumer credit operations by not reducing consumer credit interest rates. The motivation to gain an increased spread in the consumer loan operations would be particularly great at a time when problem loans and loss potentials are increasing in other areas of operation, such as in foreign loans and loans related to oil drilling, a recent experience of a number of large banks.

Given the less competitive sphere of operation than other loan operations, consumer financing has been an attractive vehicle for increasing interest rates more, or lowering them less than other rates. Even without federal preemption, the lenders have had success in constantly getting rate limits raised. In 14 states, consumer interest rate limits on personal installment loans have been removed entirely, either temporarily or permanently. In many more states, interest rate limits have been raised periodically. About two weeks ago, in the Florida legislature a banking subcommittee voted 8 to 0 to raise the consumer loan interest rate ceiling from 18 to 45 percent.

Other experience also shows that extenders of credit are taking advantage of consumers to increase their profits from the lifting of usury ceilings. For example, in Maryland, it was reported in November (Washington Post, November 29, 1982) that a survey by Maryland Attorney General Stephen Sachs' office reported that 18 out of 53 banks and other financial institutions, department stores, and oil companies raised their maximums, following an increase on July 1 on the statutory ceiling to 24 percent, during the time when interest rates were declining sharply. For example, the prime rate fell from a 15.5 to 16.5 range in July 1982 to a 11.5 to 12 percent rate in November. Since that time, of course, the prime has declined even further.

Then on April 7 the Maryland legislature passed a law that would allow banks to charge a fee for each credit card transaction and a monthly billing charge. It will also allow lenders to pass on to consumers attorneys fees and travel expenses that the institution has had to absorb. It also eases current restrictions on repossession.

In another example, in the State of Virginia, there is a recent report of state legislation being considered to allow out-of-state bank holding companies to incorporate in Virginia for the purpose of having a no-limit rate for credit cards it issued to residents in states that have interest rate ceilings. The Virginia General Assembly last year removed the 18 percent credit card interest ceiling, allowing the rate to float and be set by the market. We do not think the sort of profiteering which has occurred elsewhere in addition to Maryland and Virginia ought to be encouraged. It certainly should not be given complete freedom through federal preemption of state consumer credit usury ceilings.

A useful by-product of the state usury laws has been the enforcement of consumer protection provisions in such laws, to prevent unethical lending practices, overextension of credit, and abusive debt collection. If federal preemption of state usury ceilings is enacted, the related state consumer protection staff may be weakened or abolished in some states.

Usury laws provide affirmative help to persons of limited financial means who need a small extension of affordable credit for an emergency. Opponents of usury ceilings have argued that the usury ceiling, by precluding a higher rate of interest often prevents the necessitous borrower from obtaining his loan because the lender requires a higher interest rate in light of the loan risk and expense involved in making the loan. However, a higher interest rate would mean a still higher risk of loan default.

Interest rate ceilings also are needed to protect unsophisticated borrowers who may not be able to benefit from truth-in-lending rules, laws on unconscionable contracts and rules governing fraud. Such rules have not prevented unwary home owners in Arizona, for example, from taking second mortgages with interest rates in excess of 50 percent. Nor, have they prevented District of Columbia home owners from being induced to sign second mortgages with excessive broker fees and effective interest rates in excess of 80 percent.

According to a recent poll conducted by Hollander, Cohen Associates and published in the Washington Post on November 15, 1982, many Marylanders surveyed recently have cut down their use of bank credit cards because of increased charges. The survey showed that the greatest change in finance habits was reported by college graduates and by people aged 30 to 49 years. In this bracket, 35 percent gave up credit cards, 17 percent cut down, and 6 percent switched banks. The least change was registered by cardholders under age 30. This would suggest that younger, unsophisticated credit card users are less likely to act wisely with respect to credit than older, better educated consumers.

Increases in consumer loan rates would be sharper without the need for legislative action to raise ceiling rates and make related changes. In many cases, as when the Maryland law was passed last week, the original bill would have permitted more charges against consumer borrowers than was finally permitted, but the bill supporters had to compromise because of strong opposition.

In addition to the need for consumer protection, the macro-economic effects of unregulated consumer credit have to be considered. Housing, and to a lesser extent automobile sales, have picked up in recent months as interest rates declined to some extent. Automobile sales have been helped primarily through the auto loan rates offered by the financing subsidaries of the major auto manufacturers. For their own brands of cars, they have been offering financing at an 11.9 percent annual interest rate, while banks have been charging 13 to 17 percent. (According to one report by a Wall Street financial analyst, GMAC has been making money—not subsidizing the auto production and sale enterprise.) Some auto company financing at 9.9 percent is also being offered now.

Perhaps more reflective of financial market forces is the housing sector, where a pent-up demand boosted sales and new housing starts, as home mortgage interest rates fell from a 16–17 percent range to a 12–13 percent range. It is generally recognized, however, that even at those interest rate levels the breadth of market demand is limited; and a demand to sustain current or higher production levels for many months is unlikely unless there is a further reduction of interest rates. Three successive monthly declines in total retail sales in December, January and February indicate that it may also be difficult to get a reversal of that negative retail sales trend—a necessity for a sustained economic recovery—without lower consumer interest rates. (March may look better because Easter came early.)

That appears to be unlikely, however, given the following circumstances:

(1) The tremendous inflow of funds to money market and super NOW accounts at depository institutions, as well as a remaining large total of such fluid short term money in money market funds, foreshadowing continued strong competition for funds among investment intermediaries and a high cost of funds to them.

(2) The continued reliance upon the Federal Reserve limited monetary policy tool, which is dependent upon high interest rates to induce unselective restraint upon the economy when it begins to show signs of overheating.

Another witness at the previously mentioned October 17 oversight hearings on Consumer Interest Rates before your Consumer Affairs Subcommittee was Leonard F. O'Connor, Vice President of the First National Bank of Boston, appearing as the spokesman for the Consumers Banking Committee on whose Executive Committee he serves. In his conclusion he stated, "banks can no longer depend on funds that have been traditionally available from non-interest bearing checking accounts and low interest bearing passbook accounts." Had Mr. O'Connor explained why that had occurred, he would also have been identifying the cause of some of the following conditons he went on to cite as adding to the bankers' problems: "The unpredictable nature of the economy, the volatile nature of the marketplace, the deregulation of the liability side of the ledger, the unprecendented increase in losses due to consumer bankruptcies and the extensive regulations imposed upon the consumer banking indusry have all affected interest rates." The deregulation of the liability side of the ledger, while formally ascribable to the Congress, was really something that had to come in the wake of changes in the economic composition of the household population, which made the old statutory regulation ineffective.

The inflow of over $300 billion into money market and super NOW accounts in about 3½ months was beyond the wildest dreams of the depository institution managers. At the same time, the money market funds have still retained close to $200 billion in their accounts. These data emphasize the acceleration of a trend of over three decades: increasing deployment and redeployment of funds by an increasing number of affluent and economically literate households. These basic investors, with their sensitivity to high yields and capability to shift funds from one channel of investment to another, will force the intermediary depository institutions to compete even more fiercely, through higher interest payments to the household investor-savers, benefitting primarily the higher income households with the most savings. The higher costs of money than in prior decades will increasingly cause the institutional lenders to seek higher returns, pushing them toward high risk, high interest rate financing. At the same time, they will be inclined to retain or even increase the consumer credit interest rates.

To the extent that economic recovery develops, it is bound to increase credit demands, which will bring increases in interest rates and in the growth rate of the money supply. Fears of a too rapid expansion of the economy and rekindled inflation would then cause the "Fed" to become increasingly restrictive in its monetary policy, reinforcing the market forces that produce higher interest rates. Sales of houses and autos would be dampened and any reversal of the downtrend in total retail sales would soon be aborted.

To remove the last vestige of interest rate restriction on consumer credit under state laws, and on business and agricultural loans under the Depository Institutions and Deregulation Act of 1980, without any alternative method of holding down interest rates, would lead to future exacerbated repetitions of the 1980-81 experience. The much increased responsiveness of high-income household saver-investors to higher yields, will result in a much more rapid bidding-up of interest rates as the economy expands. Increased investment powers and relaxation of credit regulation for the institutional intermediaries will cause them to bid higher for household funds and require higher interest payments on loanable funds, which are apt to flow into increased capacity for provision of high priced goods and services—the U.S. growth markets of recent years. Mass market goods producers and distributors and home buyers and developers and consumers will also be required to pay higher interest rates; the U.S. balance of trade will suffer; and the next recession will be on its way with all of its business bankruptcies, loss of foreign markets, farm failures, and high unemployment.

Instead of adding to the financial anarchy that has been developing with more and more financial deregulation, as would happen with the enactment of S. 730, there should be a return to laws governing financing that will help in achieving stability and growth in the economy. There have been difficulties with state usury laws because of the differences between states, tending to cause outflows of funds from one state to a neighboring state with higher usury rate ceilings. That problem could be overcome in large measure by the establishment of reasonable federal usury ceilings, within which there might be state variations.

Perhaps more importantly, there has to be a way of achieving economic stability without resort to policies that depend on high interest rates to cool off an overheating economy and inflict tremendous economic hardship on the country and its citizens in the process.

In order to have a tool that can be used, in our economy of the 1980s, to achieve steadier growth without great volatility of interest rates and related prolonged periods of high unemployment, authority for credit controls should be restored. I call your attention to the table on the next page, comparing commercial bank lending rates to prime borrowers in the United States and Japan in each month during the three years 1980-1982. The fourth basic monetary policy tool, used periodically in Japan, in addition to the three that were taken from the United States kit, is credit control. It helped Japan maintain much lower interest rates, more sustained economic growth, and lower unemployment than the United States and to greatly outstrip the U.S. in international trade.

A brief use of credit controls in 1980 in the U.S. quickly brought down interest rates and restored the economy to economic growth. There have been claims that the controls which were placed in effect on March 14 were responsible for the recession which had begun in January, not a very logical sequence. A fact sheet on the 1980 credit control experience describes the sequence of events leading to the economic downturn, the credit control techniques and related measures that brought about a rapid reduction of interest rates and the economic upturn which followed. The facts refute the generalized allegation that the credit controls were responsible for bringing about the 1980 economic downturn.

Periodic use of credit controls to quickly cool off an overheating economy, while bringing down interest rates, instead of having a prolonged period of tight money and rising interest rates, would avoid the pressures for more and more increases on consumer loan interest rates in such periods. It would be of much greater help to consumers and the economy than the legislation proposed in S. 730. The AFL-CIO urges disapproval of that bill and restoration of the authority in the Credit Control Act of 1969.

Attachment.

COMMERCIAL BANK LENDING RATES TO PRIME BORROWERS UNITED STATES AND JAPAN: 1980–82

	United States	Japan
1980:		
January	15.25	6.71
February	16.75	6.95
March	19.50	7.70
April	18.50	8.60
May	14.00	9.40
June	11.50	9.27
July	11.00	9.34
August	11.50	9.27
September	13.00	8.99
October	14.50	8.82
November	17.75	8.58
December	21.50	8.30
1981:		
January	20.00	8.00
February	19.00	7.86
March	17.00	7.74
April	18.00	7.52
May	20.50	7.33
June	20.00	7.18
July	20.50	7.14
August	20.50	7.20
September	19.50	7.20
October	18.00	7.09
November	16.00	7.08
December	15.75	6.95
1982:		
January	15.75	6.77
February	16.50	6.70
March	16.50	6.65
April	16.50	6.38
May	16.50	6.36
June	16.50	6.34
July	15.50	6.33

COMMERCIAL BANK LENDING RATES TO PRIME BORROWERS UNITED STATES AND JAPAN: 1980–82—Continued

	United States	Japan
August	13.50	6.32
September	13.00	6.35
October	12.00	6.35
November	11.50	6.35
December	11.50	6.35

Source: World Financial Markets. Morgan Guaranty Trust Co.

[From the Economic Research Department AFL-CIO]

FACT SHEET ON THE 1980 CREDIT CONTROL EXPERIENCE

THE ECONOMIC CLIMATE PRIOR TO CONTROLS

In late 1979 and early 1980, the economy was suffering from a dangerous speculative fever, fueled by runaway growth in credit that pushed the inflation rate to dangerous heights. Total commercial bank loans, for example, increased at an annual rate of 13.4 percent between December 1980 and March 1981, and the inflation rate was in the 18 percent range during this period. The pursuit of tight money had failed to stem the tidal wave of inflation. The money supply, as measured by M1-B, had been increasing at moderate rates of 4.5 percent during the last quarter of 1979 and 5.1 percent the first quarter of 1980.

Even though the economy reached a cyclical peak in January and the recession had begun (according to the National Bureau of Economic Research), the CPI rose 1.4 percent during each of the first three months of 1980. Prices were rising, but industrial production, retail sales, and the index of coincident economic indicators, which tends to track the general movements of the economy, were all declining. Housing starts, a leading indicator of the course of the economy, had peaked in September 1979 at a seasonally adjusted annual rate of 1,844,000 and were on a steadily downward path to 1,041,000 in March. Interest rates were at stifling heights, as evidenced by the prime rate, which ranged between 15.75 and 16.75 percent during the first two months of 1980.

In the face of these conditions, an alternative to the existing ineffective tools of economic policy then in use was urgently needed in order to avoid a general panic. Immediate action was necessary, both because of the possibility of a wave of bankruptcies in the immediate future, and because—even with a reduction of inflation and interest rates—any meaningful recovery would require several months to take hold.

MECHANICS OF THE 1980 CONTROLS

On March 14, 1980, president Carter used the authority granted by the Credit Control Act of 1969 to require the Federal Reserve to: (a) regulate and control consumer credit; (b) regulate the finacial intermediaries primarily engaged in the extension of short-term credit; (c) regulate and control credit extended to nonmembers of the Federal Reserve System in the form of managed liabilities; and (d) prescribe appropriate record keeping with respect to all forms of credit.

Accordingly, the Federal Reserve set a 6 to 9 percent annual rate guideline for growth in bank loans. Banks and other lenders were called upon to ensure that flows of credit to small businesses, farmers, home buyers, smaller correspondent banks, and others were maintained. These loan categories, however, were not excluded from the overall quantitative guidelines related to lending. Consequently, individual banks were expected to exercise special restraint on loans to large business customers or others with access to other sources of funds, in order to ensure that credit remained available to users requiring special attention.

In order to control leakages, the Federal Reserve applied: marginal reserve requirements (initially 10 percent) on the managed liabilities (purchased funds, like negotiable CDs) of member banks; special deposit requirements on the managed liabilities of nonmember banks (initially 10 percent); a 15 percent (initial) special deposit requirement on increases in consumer credit; and a 15 percent (initial) deposit requirement on increases in money market fund assets.

RESULTS OF THE 1980 CONTROLS

Credit controls had an immediate effect in curtailing the extension of credit. The experience demonstrates that the Federal Reserve can stop the sort of speculative frenzy that existed in the winter of 1980. In contrast, the sole focus on hitting targets for the monetary aggregates had failed to halt the excessive expansion of credit.

The contraction of credit that occurred demonstrates the fallacy of the argument that because credit is fungible regulations on its extension can easily be circumvented by the financial markets. Credit controls proved to be a quick way to slow down credit growth and bring down both short- and long-term interest rates.

After controls were instituted on March 14, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July. These rapid declines set the stage for a rebound in economic activity. The annual housing starts rate rose from its May low of 938,000 to about 1,550,000 toward the end of 1980, and industrial production rose rapidly from its July low.

The rational explanation for the rapid decline in interest rates is that those banks which approached or reached their ceiling rate of credit expansion used available cash to buy interest bearing securities. In the process, they bid up security prices and bid down yields, causing interest rates on competing securities and loans to be reduced. This explanation finds support in the fact that from the end of February through the end of July 1980 commercial banks reduced total loans outstanding by 2.3 percent and the commercial/industrial loan category by 2.2 percent. Over the same period, they increased their holdings of Treasury securities by 6.7 percent and of other securities by 4.6 percent.

An important lesson from the 1980 experience is that the Federal Reserve must move carefully to inform the public about the general intent of the controls. Many consumers mistakenly believed that any use of consumer credit was prohibited. While the technical details of the controls need not be explained to the general public, it must be made clear that the use of consumer credit is allowed.

Another important lesson is that, while a policy of trying to control growth in the monetary aggregates is often ineffective, credit controls can provide a quick way to bring down interest rates.

PROBLEMS WITH MONETARISM

Disenchantment with monetarism is spreading among both academic economists and practitioners in the financial markets. Nobel Laureate James Tobin of Yale has pointed out that in recent years rapid innovations in transactions technology, financial institutions, and government regulations have radically altered the meaning of various monetary aggregates and their relationship to the ultimate targets of economic policy—growth, employment, lowered inflation. Professor Benjamin Friedman of Harvard has demonstrated that "the aggregate outstanding indebtedness of all nonfinancial borrowers" in the United States has just as close and stable a relationship to total nonfinancial activity as the money supply. He concludes the Fed should target both a credit and a monetary aggregate in its conduct of monetary policy. Anthony Solomon, President of the Federal Reserve Board of New York, has pointed out that as more and more of the assets included in the monetary aggregates pay market interest rates, the aggregates become less sensitive to interest rates. When the Fed wants to slow down monetary growth, it sells securities, driving up the federal funds rate. Other market rates rise, but so do the yields on instruments earning market rates included in the monetary aggregates. As a result, there will be less incentive to shift out of the monetary aggregates. Eventually, aggregate demand and GNP decline in response to higher interest rates—not to slower monetary growth. Solomon points out that today the cost of credit, rather than its availability, affects the economy. Interest rates must now rise further to have an effect. As a result, the fragility of the economy has increased. One remedy suggested by Solomon is for the Fed to focus on a credit target instead of the monetary targets. Al Wojnilower, of the First Boston Corporation, makes the same observation that interest rates rather than the availability of credit now influence the course of the economy. Because of such adaptions to higher rates as floating rate contracts and interest rate futures, there has been a marked increase in the persistence of high interest rates and a greater risk of financial panics. Similarly, Henry Kaufman of Salomon Brothers has noted that monetary policy, as currently conducted, relies solely on interest rates rather than credit availability to attain its goals.

The pervasive theme of this criticism is that monetarism doesn't work. Because of ongoing innovations, the aggregates aren't accurately measurable, easily controlled, or stably related to economic activity (GNP). Thus, high interest rates have become the cutting edge of monetary policy; but, because of structural change and the failure to control the availability of credit, interest rates remain high for much longer periods than in the past. We conclude, therefore, that the availability of credit must be controlled if these extended periods of high interest rates are to be eliminated.

FOREIGN EXPERIENCE WITH CREDIT CONTROLS

Japan has used credit controls in recent years to keep interest rates, inflation, and unemployment at low levels, while assuring that capital flows into productive, cost-reducing investments.

Discussing monetary policy in a recent study of the Japanese Financial System prepared for the Joint Economic Committee by a staff member of the Japanese Ministry of Finance, the author (Eisuke Sakakibara) states: "In addition to credit policy, the authorities often used window guidance to attempt to curtail bank loans directly. Although window guidance was sometimes heralded as a major policy instrument, it was actually only a supplementary tool. The Bank of Japan itself has said: 'Window guidance is a supplemental tool to general monetary policy tools such as discount rate changes, rather than an independent weapon of monetary control. In other words, while these tools exert pressure on the market, window guidance is a tool that reinforces them from the side. Since window guidance functions only as a supplemental tool of monetary policy, it would not be sufficiently effective unless it is used hand in hand with powerful enforcement of more orthodox tools of monetary policy.' "

Part of the credit controls implemented in the U.S. in 1980 were a fairly close copy of "window guidance" which has been used from time to time in Japan. Some of the more selective credit control measures used in Japan, when appropriate to promote stability, could also be used here under authority of the Credit Control Act. Recently, for example, the authorities in Japan have forbidden the sale of zero coupon bonds in Japan, restricted the ability of Japanese banks to make loans denominated in foreign currencies, and tightened restrictions on yen-denominated loans to foreigners.

The CHAIRMAN. Thank you very much.

Mr. Schechter, are you talking about money market funds themselves? Are you suggesting we should not have removed interest rate ceilings?

Mr. SCHECHTER. I'm suggesting it doesn't matter. The money market funds and the money market accounts are simply a facilitation of what was already taking place.

The CHAIRMAN. Absolutely.

Mr. SCHECHTER. So, it speeded up the process a little, but once that has been done, we have no tool, really, that is effective in let's say cooling off the economy, without a tremendous upsurge of further interest rates, the way we saw happened in 1981 and 1982.

When the Fed started tightening, everybody got the idea that they would tighten some more. There was the anticipation.

BORROWING AND SHIFTING FUNDS

So, they run in and borrow and then shift funds to higher yielding securities, again. And it's taken an awfully prolonged time until the objective of monetary policy, which is to dampen total aggregate demand, took hold.

During that process, of course, we got all those experiences I've talked about. Business failures increasing at 50 percent per year for a few years, farm failures, housing and auto industries collapsing, and the very deep recession we've had, the deepest since World War II. And most prolonged.

So, I say there is no way we're going to avoid those things, unless we do get another tool. Instead of saying, We'll just let go of everything, and it will cure itself.

I don't think it will.

JUSTIFICATION OF REGULATION Q

The **Chairman**. Well, what justification was there to have a regulation Q that says to businesses that they can't pay a consumer more than 5¼ percent?

Mr. **Schechter**. As this, what I call educated and affluent household sector developed and funds began to be shifted around, regulation Q got to be ineffective. As a matter of fact—but when we had the S&Ls, for example——

The **Chairman**. It was a great penalty to the average consumer, was it not?

Mr. **Schechter**. Not to the average consumer. It was probably a penalty to the consumer that has a fairly high income and has a lot of savings.

The **Chairman**. Wasn't it a penalty to somebody with a small account to say they can only earn 5¼ percent?

Mr. **Schechter**. But Senator, the reason I think it was not a penalty to them, is because they derive very little in the way of additional interest from a small account, but higher interest rates feed into the prices of everything that is bought. And for the low income consumer, the chances are, his additional costs, because the high interest rates that had to be paid that were reflected in prices, probably outweighed the few extra dollars he earned from interest.

The **Chairman**. Well, we have a basic disagreement there on whether government should be involved in telling the person how much they can earn on their savings account without regard to size. Whether or not it is a small amount in absolute dollars that they earn, it is still objectionable to me that government was saying, this is all you can pay, especially at a time when the market was demanding more.

Mr. **Schechter**. I think we are in agreement, Senator, that this became an ineffective tool, but I think at one point it probably worked. So, on that, we are in agreement.

The **Chairman**. Well, basically, in a stable economy, it guaranteed savings and loans, particularly, a profit. That is what it did. Regardless of individual account sizes, it guaranteed them a profit, because that is all they had to pay. They had to make no great management decisions. It didn't require a great deal of intelligence to be a successful savings and loan president, with the government telling you what basket you put your assets in, and how much you could pay. You couldn't pay more than 5¼ percent, so inertia was present. People keep their account in a traditional depository account, when they could have been earning money someplace else but weren't, because they didn't know about it.

Mr. **Schechter**. But as we deregulated, though, they got into trouble. The first move toward deregulation was the 6-month money market certificate. And they thought they had reached a solution to their balance sheet problem, but it turned out they couldn't really use that solution and make mortgage loans, because pretty soon they were paying more, not only the old inventory of mortgages they had, but they could not place their funds in mortgages. Even for new mortgages, they couldn't place all their money at a rate that would give them a margin of profit. That was happening in 1980 and 1981, when they had a very high liquidity ratio, much higher than the Bank Board required. They were carrying that and carrying short-term securities where they could get a higher rate for the time being, because they couldn't afford—they couldn't place all that money in mortgages, at the rate they would have to charge.

The CHAIRMAN. I would agree completely with you on the fact that the basis of the whole problem for everyone has been high-interest rates. Where our fundamental difference of opinion occurs is, whether we can solve that problem with interest rate ceilings, usury ceilings or arbitrary decisions by lawmakers. Many times these decisions are politically motivated, because it is nice to say I am trying to do something about it. We have totally ignored the $1,300 billion national debt and the fiscal irresponsibility of Congress for the last 30 years, under both Republican and Democratic Presidents. I haven't heard a thing said, and I very rarely do, about the fact that the fundamental cause of high-interest rates is an irresponsible fiscal policy.

Mr. SCHECHTER. If I may respond.

The CHAIRMAN. Certainly.

INFLATION CAUSED BY EXPENDITURES

Mr. SCHECHTER. Inflation will be caused by expenditures, whether they are governmental or not, during this period, especially, of increasing interest rates, where we have an increasing flow of income through interest payments. For example, between 1981 and 1982, total personal income rose, I believe, 6.3 percent. Wage and salaries rose 4.9 percent. Interest income rose over 13 percent. The share of total income going into interest was increasing rapidly and actually, even in the quintile distribution of family income, there has been a shift in the last few years, a greater proportion of total income going to the high income families. At the same, we have had increases in the types of expenditures which low-income people don't make. We have had a boom in the pleasure boat industry. We have had quite an increase in private airplane ownership. We have had a great increase in travel abroad and purchases abroad.

In other words, I would say, sir, these types of expenditures cause inflation too, perhaps more than food stamps, sir. So, I think it isn't just one side. We have a different type of economy which has taken place and which has developed, as family incomes, on the whole, real purchasing power, after taking care of inflation, after adjusting for inflation, doubled between about 1950 and 1980. And the people at the top got an awful lot of discretionary income, about the top 20 or 40 percent, actually.

And these last few years, with high interest rates, exacerbated that. So, that we have a totally different sort of economy, in investment decisionmaking, in the flow of funds through different channels and in types of expenditures being made. And until we really change our institutions to take care of that, I think we are fighting this year's war with World War I weapons.

The CHAIRMAN. I wouldn't try to indicate to you or anybody else that Government spending is the only cause of inflation. You are correct that there are certainly other causes. But, in spite of everything I have studied for the last few years I continue to believe that Government is more responsible than all the other causes put together. We simply cannot continue the spending binge, whether it is for food stamps or whatever, and have Government borrowing more than 50 percent of all the available capital in the country, as it did in the last quarter of last year, and not expect that you are creating a shortage of capital for other expenditures, such as modernization of steel plants, automobile factories, and everything else.

The result, of course, is to drive interest rates up. Then, you tell me that all we have got to do is keep usury ceilings on, and we can keep interest rates down. That's like a pressure cooker. You can keep the lid on for a certain amount of time, but then the pressure builds up and it's going to blow. You've got to attack the fundamental problems.

Mr. SCHECHTER. We, certainly, I think, shouldn't have had the revenue cuts that were enacted. It, of course, exacerbated the entire problem of the deficit, and at the same time, having high interest rates, so that we are not paying about 10 percent—the Government is paying about a 10 percent average rate on its debt, or $100 billion a year on interest.

The CHAIRMAN. I'll stop, Henry, because I'm getting away from the problem of usury rates. We also could get into a debate over revenue. I am not one who would balance the budget by increased revenues, because then you haven't accomplished very much. There are two ways to do it. You can decrease expenditures, or you can increase revenues. If the Government is taking more than 40 percent of the GNP in taxes, either you're financing the debt by borrowing or you are taking it away from the people by taxation, but either way you're still removing it from the private capital markets and making it unavailable for steel.

In my State, we are still operating with the World War II steel plants. So, however you take it away from the people, through borrowing or increased taxation—I am not in favor of an increase in revenue. I am in favor of cutting expenditures. But I will stop, because I love to discuss it with you, and I mean that sincerely, but we are getting away from S. 730, and I shouldn't do that.

Maybe we can just get together and discuss that someday.

Mr. SCHECHTER. I would enjoy that.

The CHAIRMAN. I am very serious. I do love having you come because I tend to get away from the subjects that we were supposed to be talking about.

Ms. Broadman, you made a statement which I agree with completely. As you know, as a nonattorney, Senator Proxmire and I are among a minority of the Senate who do not have legal backgrounds, so we certainly would appreciate plain English in a lot of things that we do.

I want to compliment you for your position on that although it puzzles me a little bit. For the last 8 years I have tried to get some plain English on simple forms, and so has Senator Proxmire. In Truth in Lending, we tried to get simple things like "You have borrowed this much; You will pay back this much; You will pay this much interest," and so on. That has been our major point of disagreement on Truth in Lending.

I have always felt that the act in its present form is anticonsumer, because the forms are just too complex. I don't even understand them, and I have been on the committee for eight years.

How do we get to a point where we can work together on some plain language on a lot of these things, not just the consumer protections you're talking about today, but in Truth-in-Lending, I would like to get some real reform? Are you ready to advocate some real, honest-to-goodness simplification of the form so that its not any bigger than this; so that even a dumb senator can understand the terms of the loan that he is receiving?

Ms. BROADMAN. Let me say, I have always shared your view that Truth-in-Lending disclosures should be simple, so the consumer can understand them. Where I disagree with you is over the amount of information the consumer should be given. We have always felt the consumer should get more information, but in very simple, plain language. What we are proposing today is something like the New York bill that just requires that all consumer credit contracts be written in language that people can understand. There are several States that do have plain language laws that you can take a look at in trying to draft the national plain language law. It is something that we have enough information on and something we feel very strongly should accompany any sort of usury preemption, so that consumers can protect themselves, and so that consumers can understand the contract terms that are tied into the contract charges and can also understand precisely what they are being charged and protect themselves.

We think usury ceilings are needed, because even with plain language contracts, there will be people who will not be able to protect themselves, but at least you'd be helping those consumers who could understand the contracts and could avoid undesirable consumer contracts.

The CHAIRMAN. I wish we could achieve that goal of having them understand. I have yet to see RESPA, truth-in-leasing and truth-in-lending with understandable disclosures. They are not understandable to me. I remember Senator Morgan and I, the first year we were senators, introduced a simplification of the Real Estate Settlement Procedures Act and were widely hailed as having done a great job.

Two-and-a-half years ago, for the first time after that, I took out a mortgage loan, Here I was the Chairman of the Banking Committee, who had authored a simplification in RESPA. The banker handed me one sheet after another to sign and to read, and I said, "I am going to take the time to do this and not just the usual formality of signing and reading it quickly." So, I went home and I read each of those disclosures, and I am still not sure what I agreed to. That was after the simplification.

I was not well-served by RESPA. So I am puzzled and frustrated by how consumer groups and others can come together in the name of consumers and support that sort of law. I am not being facetious. I have those forms at home. They were all in legalese, and I still don't fully understand all that was disclosed to me. I guess I could hire an attorney to tell me, but then it comes to mind that the lower income person who goes in to get a loan has to handle those same forms. If I can't figure them out, how does that poor, underprivileged consumer? Again, I can't answer that question today, but I wish it were possible for us to come to some agreement. It might be better to have them understand what is correctly disclosed to them, before we try to disclose more that they can't understand.

Ms. BROADMAN. There are two issues. One is the disclosure issue. What do you want in the Truth-in-Lending statement? The other is, how do you want the contract to look? When you go in and purchase a home or purchase consumer credit, the most confusing provisions are the contract language, not the Truth-in-Lending disclosure and not the RESPA disclosure. The disclosures required by law can be regulated by statute to make them simpler, but what we are talking about is simplifying the contract terms, so the consumers can understand the underlying contracts.

The CHAIRMAN. I agree. I can't understand the disclosures as a nonattorney, and I obviously don't understand the contracts. I have often felt that this was deliberate. It is very profitable to the legal profession in this country to have things that are difficult to understand, because then they can charge high fees to those of us who are not trained in the law to interpret what is done. It also has led to an incredible number of highly technical and supercritical lawsuits that cost people who want to fight legal fees, court costs and all that sort of thing.

This is also true of insurance contracts. I spent a good deal of my time making my living selling insurance before I got into politics. I am not sure I ever understood what the actual contract entailed when I delivered it. So, I don't know how my customers ever understood it.

To get back to where I started; I enjoy plain English. I wish there were some way, in a lot of different areas, we could make it so not just the poor and underprivileged could understand, but some of us who are in a better position to judge, but still don't understand the fine print.

The excuse is always, you have to be very precise, so when you get into court you will have some legal basis.

I don't understand all the hereases and wheretos, and that sort of thing. I would hope that we could work together on plain language, plain English in a lot of things. But I don't know how you overcome the legal profession in doing that. They have a great vested interest in language that is unintelligble to us mere mortals.

Mr. Nishimura, my time is up, but you wanted to respond.

DEFINITION OF INTEREST

Mr. NISHIMURA. Yes, Senator, as far as the rate is concerned and the contract terms, I think we would be making great strides if we defined—as Arkansas really does. Generally, if it is not principal, it is interest. Whatever you call it—you can call it an origination fee; you can call it an attorney's fee; you can call it a payback fee—if it is not principal, it is interest.

That definition, which is very strong, has helped people in Arkansas understand the usury laws and how to use it, but it works in tandem with the other provision; that is, the penalty provision. If a lender lends at a usurious rate, the penalty is loss of principal and interest.

It is very severe, we agree, but what that does is puts the burden on the lender to assure that the lending laws are being followed. And even in the case of a low income or unsophisticated borrower, the incentive is there for the lender to assure that the conditions of the loan are legal.

The CHAIRMAN. Well, remember, it has not been mentioned by any one of you three that I have always insisted in any Federal preemptions that there be a right for the State to override. Even if all the difficult circumstances would arise with Federal preemption, as you indicate—and I think some of them are real possibilities; others are not. There is a 3-year period for any State legislature to say we disagree totally. Arkansas would have the right to do anything they wanted and totally reject this, and if it were not for that provision I would not support this federal override.

I would like you not to ignore that right for any State to establish any of these conditions, as you have just talked about in the case of Arkansas, during a 3-year period. That gives most States at least one and, in many cases, two or three legislative sessions to do that after the enactment of the bill.

My time is way up. Let me turn to Senator Proxmire.

Senator PROXMIRE. First, I want to congratulate the three of you for your statements. I think you were very good, very strong and forceful and quite persuasive.

Mr. Schechter, I called to Governor Partee's attention your contention that the consumer borrows in an administered market and the competition is far less for lenders who lend to consumers than it is for lenders who lend to business generally.

He said that is less and less true. The consumer's market is becoming more and more competitive. How would you answer?

Mr. SCHECHTER. Well, I have cited some figures, and there were more cited at the hearing of March 17, which I mentioned.

During the decline of interest rates we have had during the second half of 1982 and so far in 1983, there certainly has been a tremendous lag, almost no decline, in consumer interest rates, and in some types of consumer interest rates there has been an increase, like in credit card charges.

If there were as much competition as in other types of lending, there certainly would have been more of a movement in line with the decline of the prime rate, mortgage rates, and so on, but this did not happen. There was an increasing spread between other rates and consumer interest rates.

So I think you might say that is the proof of the pudding, that it is not as competitive as other types of lending.

CONSUMER CONFINED TO HIS LOCAL MARKET

I think the reason is—as I cited in my testimony— the consumer, unlike a business borrower, let us say, is pretty well confined to his local market. The large corporate borrower, of course, is wooed by banks from all over the country. He has his choice. And even a moderate sized business will shop around more.

But the consumer generally is in his local market, and when you have some institutions, like the Bank of America, with all its branches in California, or Citicorp, with its 220 branches in New York City, they don't really have to compete, I think. They have got so many customers that have their accounts there that that is the first place they will turn for a loan.

That is what I call a semicaptive market.

Senator PROXMIRE. I appreciate that very much. Would you, to the extent you could do so, document that for the record, showing what has happened to consumer rates, and also give me the specific reference to the credit card situation in which you said the credit card rates have actually gone up when other rates were going down?

Mr. SCHECHTER. Yes.

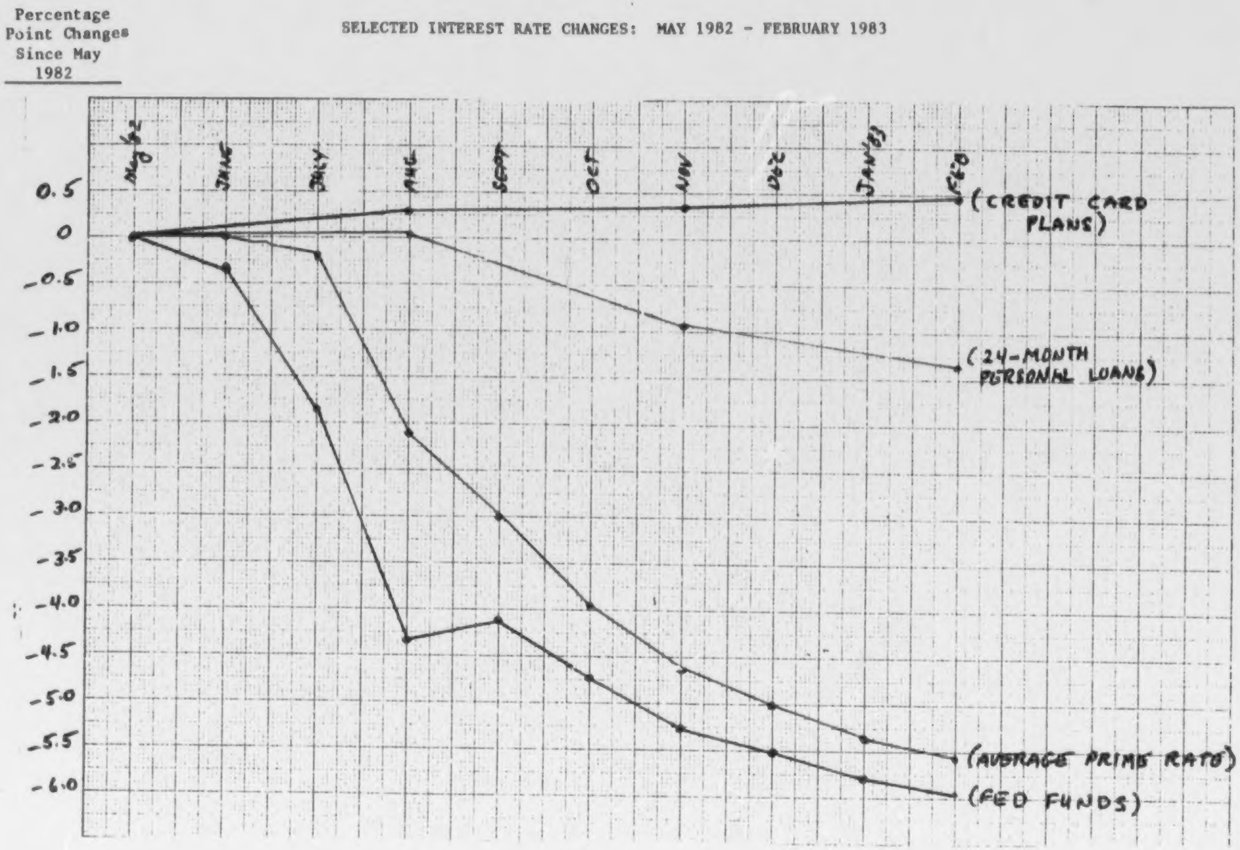
[Information supplied for the record follows:]

SELECTED INTEREST RATES
MAY 1982 - FEBRUARY 1983
(percent)

Month	Average Prime Loan Rate	Federal Funds Rate	24-Month Personal Loans Rate	Credit Card Plans Rate
1982 May	16.50	14.45	13.90	18.41
June	16.50	14.15		
July	16.26	12.59		
August	14.39	10.12	18.93	18.73
September	13.50	10.31		
October	12.52	9.71		
November	11.85	9.20	17.99	18.75
December	11.50	8.95		
1983 January	11.16	8.68		
February	10.98	8.51	17.59	18.89

Sources: Federal Reserve Bulletin for first two columns; Federal Reserve Board Statistical Quarterly Releases E-12, G-19 for periods shown

SELECTED INTEREST RATE CHANGES: MAY 1982 - FEBRUARY 1983



SOURCE: Federal Reserve Bulletin and Federal Reserve Statistical Release E 12 and G 19 for indicated periods.

NEW JERSEY USURY LIFTED RATES GO UP

Senator Proxmire. Mr. Nishimura, again a very strong statement. You say—at the bottom of your first page, you say New Jersey usury ceilings were lifted in 1981, allowing finance companies to charge up to 30 percent for loans. The State average for these types of loans had been the national average of about 21 percent. As soon as the new law became effective, the rates shot up 6 to 7 percent and stayed at that high level.

Again, I would appreciate any specific reference you could give us, going up to 26 to 27 percent. Are they still at that level now?

Mr. Nishimura. Senator, I was quoting from a study by the New Jersey Consumers League, which I will be happy to furnish for you.

Senator Proxmire. Thank you.

[Information supplied for the record follows:]

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SUMMARY OF SURVEYS OF N.J. DEPARTMENT OF BANKING

The New Jersey Department of Banking has published two reports to the Legislature on New Jersey interest rates. The Consumers League of New Jersey abstracted the following data from these Banking Department reports, to make interest rate trends easier to see. By "banks" we mean also savings banks and savings and loan associations (Rates for all banks were averaged - there was rarely more than a one point difference in the averages of the three types of banks.) The rates given are the average rates (except for the last column, which is the highest single rate recorded). The January 1981 interest rates are for a period prior to the legalization of 30% interest on March 31, 1981.

Creditor	Loan/ Security	Jan. 81	Aug. 81	June 82	Oct. 82	Highest Rate
Banks	credit card:					
	- cash	12.78	16.67	18.34	18.18	n/a
	- purchases	12.59	15.82	18.02	18.10	n/a
Banks	personal	13.61	19.37	19.51	18.13	25
Banks	2nd mortgage	14.89	18.55	18.19	16.30	22
Banks	new car	13.70	17.82	17.71	15.42	21
Banks	used car	13.85	18.73	18.66	16.58	28
Finance Cos.	small loan	21.37	27.93	n/a	26.84	30
Secondary Mortgage Licensees	second mtg. loan	17.98	21.43	n/a	20.16	29
Merchants	installment sales contract	17.99	22.35	n/a	22.01	30
Ins. Premium financier	insurance premium	16.33	19.38	n/a	19.87	30
Contractor	home repair contract	12.88	17.94	n/a	18.5	24

Dept. Store	charge card	n/a	19.6(Dec. 81)	19.9(Jan. 83)	21.6

Our Observations

1. All creditors are charging more than they did prior to "deregulation." Not one average loan rate after "deregulation" is lower than the January 1981 rate before "deregulation".

2. "Deregulation" greatly increased the cost of credit to New Jersey residents. For example, when bank credit card rates increase from apx. 12% to 18%, that is an increase in the cost of credit of 6/12, i.e. 50% more expensive. If small loans increase from apx. 21% to 28%, that is an increase of 7/21 = 33% more expensive.

3. Several types of creditor actually increased their rates in October 1982 (a period of falling national interest rates). Comparing June 1982 and October 1982, no type of bank credit decreased more than 2.4 percentage points (bank credit cards essentially stayed the same), while no type of nonbank credit decreased more than 1.3 percentage points (with department store charge cards, home repair contracts, and insurance premium financing becoming more expensive).

4. Unfortunately the Department of Banking did not provide data for June 1982 for the nonbank creditors. These creditors subject consumers to the greatest interest rate abuse, hence they deserve closer watching by the Banking Department. The mail survey used by the Department also can be ignored by high interest creditors not wanting to disclose a 30% rate charged.

SURVEYS OF CONSUMERS LEAGUE AND BANKING DEPARTMENT COMBINED

Creditor	Jan. 81	Aug. 81	9/30/81	12/10/81	June 82	Oct. 82.	10/27/82	1/28/83	Highest
	Personal Loan								
Banks	13.61	19.37	18.37	18.94	19.51	19.13	19.28	18.46	25
Finance Co.	21.37	27.93	25.20	28.08	n/a	26.84	28.00	27.43	30
	Loan secured by Second Mortgage								
Banks	14.89	18.55	18.00	19.07	18.19	16.30	16.30	15.64	22
Licensees	17.98	21.43	22.82	24.75	n/a	20.16	21.01	20.54	30
National Interest Rate Trends		Mostly Rising	Falling	Falling	Rising	Falling	Falling	Falling	

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CONSUMER LOAN RATES GO UP AND STAY UP: NEW JERSEY CREDITORS FAIL TO PASS ON LOWER INTEREST RATES TO CONSUMERS

Four Surveys of New Jersey Loan Rates After "Deregulation"

BY: Neil J. Fogarty, Esq.
Member, Board of Directors

On March 31, 1981 New Jersey legalized 30% loan interest for consumer creditors. The theory advanced at the time was that interest, the price of money, would respond to "market" conditions, and so consumer interest rates would rise and fall (like the price of vegtables).

The Consumers League of New Jersey has taken four surveys of prevailing consumer interest rates to test whether market "competition" has in fact worked as predicted in New Jersey.

The surveys were taken on September 30, 1981, December 10, 1981, October 27, 1982, and January 28, 1983. The method used was to call banks (of all types), finance companies, and secondary mortgage act licensees, then ask them what they were charging on personal loans and on loans secured by a second mortgage on one's home. The rates given are an average of lenders of that type.

National Interest Rates Fall

The four survey dates should be thought of as two pairs. Each pair of dates falls within a time period when interest rates in the national economy fell drastically.

First Period - July to December 1981

From July 1981 to December 1981 short term interest rates (e.g., federal funds, one-month commercial paper, three months treasury bills) fell from about 20% to 11%. During this time of plummeting interest rates, New Jersey creditors actually increased consumer loan rates:

	Survey 1 9/30/81	Survey 2 12/10/81
Personal Loans		
Banks	18.37%	18.94%
Finance Companies	25.20%	28.08%
Second Mortgage Loans		
Banks	18.00%	19.07%
Second Mortgage Licensees	22.82%	24.75%

Hence the first pair of surveys shows that when the cost of money fell in the national economy during summer and fall 1981, New Jersey lenders actually raised the above consumer loan rates.

Second Period: July 1982 through January 1983

A much heralded "break" in national interest rates happened at the beginning of July 1982 and has continued through January 1983. Short term rates fell from approximately 15% to 8%. Major banks reduced the "prime" rate (charged to large corporations) from 16.5% to 11%. Surveys 3 and 4 tested whether consumers also experienced any interest rate reduction:

	Survey 3 10/27/82	Survey 4 1/28/83
Personal Loans		
Banks	18.28%	18.46%
Finance Companies	28.00%	27.43%
Second Mortgage Loans		
Banks	16.50%	15.64%
Second Mortgage Licensees	21.01%	20.54%

The second pair of surveys shows that a full seven months of falling interest rates failed to budge the personal loan rates of banks and finance companies by more than one half of a percentage point. Second mortgage loan rates dropped almost one point for the banks, about one half point for the secondary mortgage act licensees.

New Jersey Interest Rates Stay Up

Putting the four surveys together, we can get some idea about whether consumer interest rates go up and down with "market" conditions.

Creditor	Ceiling Prior to Mar. 31 1981	Survey 1 9/30/81	Survey 2 12/10/81	Survey 3 10/27/82	Survey 4 1/28/83
Personal Loans					
Banks	12%	18.37%	18.94%	18.28%	18.46%
Finance Companies	21%[1]	25.20%	28.08%	28.00%	27.43%
Loans Secured with Second Mortgage					
Banks	18%	18.00%	19.07%	16.50%	15.64%

---

[1] The former ceiling for small loan companies allowed 24% on the last $500 to be repaid, 22% on the next $1000, and 18% on the balance. The "21%" quoted is the effective rate for a typical loan.

Licensees	18%	22.82%	24.75%	21.01%	20.54%

Thus New Jersey personal loan rates simply went up and stayed up, impervious to the movement of national interest rates downward. Two charts are attached which compare the upward movement of small loan rates against falling short term interest rates. Both banks and finance companies failed to reduce personal loan rates.

Apart from the question of why the personal loan rates did not come down, one may ask why finance company credit costs 46.8% more than bank credit costs. Beneficial Finance Co. states that the demographics of its customers are the same as commercial bank customers (1979 Annual Report, p.11). Beneficial also states that its primary internal source of funds to lend is the money borrowers repay each month on old loans (Bond Prospectus, Dec. 16, 1981, p.8). Once a finance company has "paid for" such capital, it can relend this repayment money indefinitely at virtually no cost for the funds.

Second mortgage rates by banks showed modest downward variation. However in the first two surveys, banks were charging on the average nearly the same rates for unsecured loans as they were for loans with a second mortgage on a home - compare 18.37% (unsecured) with 18% (second mortgage), and 18.94% with 19.07%. This suggests that second mortgage rates were much too high in September 1981 and December 1981 (second mortgage rates should be lower than unsecured loans since the bank has little risk).

Loans by secondary mortgage act licensees were 28.75% more expensive than the same loans by banks. Their rates moved upward, then came down a few points, but never below the old 18% usury ceiling. One may question whether "competition" in second mortgage lending exists when all the bank rates were found in one cluster and all the secondary mortgage licensee rates were found in a second cluster (28.75% higher than the average bank rate). In taking these surveys, we found evasiveness about quoting their rates among certain second mortgage lenders. Several times the advertised rate turned out to be merely the lowest rate. Several lenders said that they did not have a maximum rate. (This could be interpreted as a willingness to charge 30% for a second mortgage. Indeed at least one second mortgage creditor has charged 29.94% - see exhibit E.) Hence it is hard to tell if the second mortgage rates cited need an upward adjustment.

High Interest Abuses

On March 31, 1981 New Jersey legalized 30% interest for consumer creditors which had previously been regulated, including:

- auto dealers,
- merchants,
- home repair contractors, and
- insurance premium financiers.

It was not possible to survey all those creditors. We found that merchants (especially ghetto merchants) and car dealers were reluctant to quote their interest rates over the phone. A kind of "interest rate schizophrenia" also prevails at certain car dealers. Compare exhibits G and H to see a large car dealership which participates in interest rate sales (sponsored by General

Motors Acceptance Corp.) with rates as low as 8.9%, yet also has charged a customer 29.96%. Attached also are contracts from merchants, car dealers, second mortgage lenders and insurance premium financiers at annual percentage rates of 41.25%, 36.94%, 33.53%, 30% and 29%.

Some consumers have reported that creditors have quoted interest calculated by the misleading (and illegal to disclose) "add-on" method of calculation. For example, a consumer is told orally that the rate is "18%" when the annual percentage rate is actually 29%.

Several contracts have been found in which creditors exceeded 30% annual percentage rate and disclosed incorrect annual percentage rates (see exhibits B, C, and D).

More fundamentally one may inquire whether some creditors, including national finance companies are, in view of falling interest rates, legally charging excessive interest. Some finance companies routinely charge 30% to New Jersey borrowers, no matter what the cost of money is. The chart below shows the highest rates discovered in the surveys.

Highest Rate Discovered

Creditor	Survey 1	Survey 2	Survey 3	Survey 4
	Personal Loans			
Banks	20%	24%	20%	22%
Finance Cos.	28%	30%	30%	30%
	Second Mortgage Loans			
Banks	18%	21.5%	18%	18%
Licensees	26%	30%	28%	25%*

(*We have previously stated our suspicion that some second mortgage lenders were unwilling to disclose their highest rate charged.)

Some Creditors Charge Lower Rates in New York

In December 1980, New York raised its consumer usury ceilings to 25%. We wanted to see what rates were charged by national finance companies which operated offices both in New Jersey and in New York (either directly or through state subsidiaries). We called on October 27, 1982 and January 28, 1983. The three finance companies were chosen because of their large size.

Personal Loans by Finance Companies

Company	New Jersey Office		New York Office	
	10/27/82	1/28/83	10/27/82	1/28/83
AVCO	27%	27%	25%	25%
Beneficial	28%	28%	25%	25%
HFC	30%	30%	25%	25%

Credit was freely available at all the offices called in both states on both dates. Employees, thinking I was a loan applicant, were eager to take an application over the phone. So why are New Jersey borrowers charged more than New York borrowers?

This is not to suggest that interest rates in New York behave more "competitively". A survey taken by the Amalgamated Bank of New York in January 1983 found that personal loans cost 19% on the average at New York banks, see exhibit L. New York bank credit cards rates have also failed to decrease, see exhibit M. Edward M. Katz, president of the Amalgamated Bank of New York, is quoted in the February 1, 1983 Jersey Journal (p.17) as stating: "There's no question but that consumer loan rates could be lower; even the prime rate could come down lower. Banks are paying substantially less than 9 percent for money and yet the margin or spread is wider than it's ever been historically when they're charging 17 to 19 percent for auto and personal loans." The Amalgamated Bank was charging as low as 13.25% on auto loans and 15.25% on personal loans at the end of January 1983. Bank president Katz commented: "If this 13.25 percent rate is not losing us any money, there's no reason other banks can't offer it."

Conclusions

For almost two years consumer interest rates in New Jersey have been free to rise and fall, limited only by New Jersey's 30% criminal usury law, N.J.S. 2C:21-19. Despite two periods of falling national interest rates, interest rates rose and failed to come down on personal loans by New Jersey banks and finance companies. Second mortgage rates by banks first rose in a period of nationally declining rates, then fell. Second mortgage act licensee rates fluctuated only above the 20% mark. Except for bank second mortgage loans (which seemed overpriced in Surveys 1 and 2), the creditors surveyed did not pass on the lowered cost of money to consumers in the form of lower loan rates. In short, consumer interest rates were quickly raised and in general have yet to be lowered. Several national finance companies are charging New Jersey consumers higher rates than they charge their New York customers. The New Jersey experiment in interest rates "freely" responding to "market" conditions does not seem to be working. Further, some creditors, including inner city merchants, auto dealers, finance companies, second mortgage lenders, and insurance premium financiers, have charged excessively high rates of 30% (a few even exceeding 30%), causing one to conclude that a 30% ceiling does not adequately protect New Jersey consumers against interest rate gouging. The lesson seems to be that if the Legislature legalizes a high rate, then many creditors will not hesitate to charge that rate even in periods when the cost of money is low. In contrast, New York's 25% ceiling protects consumers without limiting the availability of credit.

APPENDIX

Exhibit

A - Charts Comparing Rising Finance Company Rates with Falling Cost of Money.

B - Refrigerator sold on credit at 41.25% annual percentage rate by Grossman Furniture Co, Irvington (disclosure of "19.10%" is incorrect).

C - Auto insurance premium financing contract, correct annual percentage rate is 36.94%.

D - Auto insurance premium financing contract, correct annual percentage rate is 33.53%.

E - Loan secured by second mortgage on home, 29.74% annual percentage rate (note also $1,463 charge for credit insurance and the $25,187 finance charge).

F - New car sale at 28.98% annual percentage rate: credit by: Compass Lincoln-Mercury and Ford Motor Credit Co.

G - Portion of January 5, 1983 ad by Potamkin Chevrolet advertising 8.9% APR credit on new 1983 cars.

H - Used car sale by Potamkin Motors Corp. on May 7, 1982 at 29.96% - assigned to United National Bank.

I - Furniture sale at 30% annual percentage rate (no APR was disclosed to the consumer).

J - Used car sale at 29.95%.

K - Used car sale at 29.99%, contract of General Toyota, assigned to Heritage Bank-North.

L - Results of Interest Rate Survey by Amalgamated Bank of New York.

M - What Are New York Banks Charging on Credit Card Cash Advances?

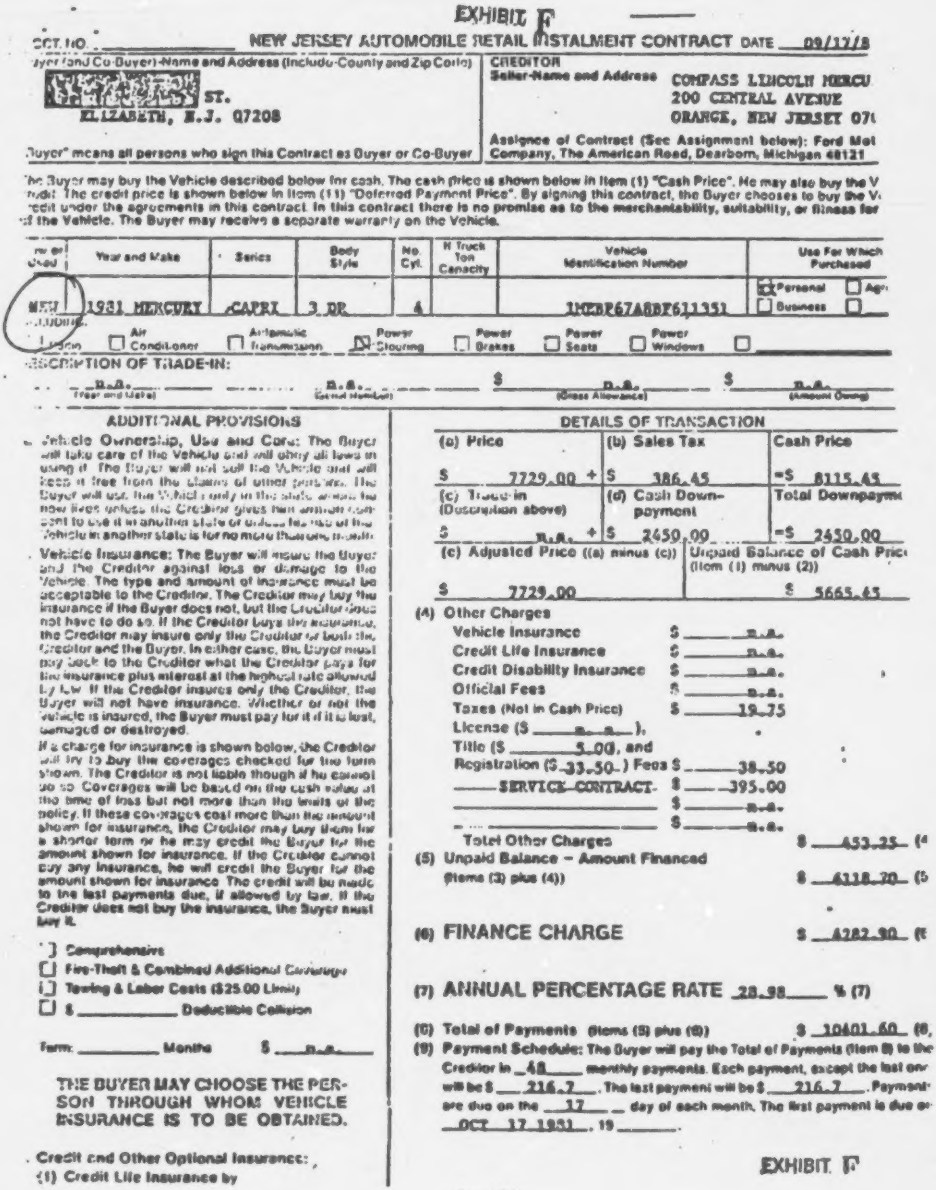


EXHIBIT F

…CT. NO. ______________ **NEW JERSEY AUTOMOBILE RETAIL INSTALMENT CONTRACT** DATE 09/17/8

…yer (and Co-Buyer)-Name and Address (Include County and Zip Code)
[redacted] ST.
ELIZABETH, N.J. 07208

…uyer" means all persons who sign this Contract as Buyer or Co-Buyer

CREDITOR
Seller-Name and Address
COMPASS LINCOLN MERCU
200 CENTRAL AVENUE
ORANGE, NEW JERSEY 07

Assignee of Contract (See Assignment below): Ford Mot
Company, The American Road, Dearborn, Michigan 48121

…he Buyer may buy the Vehicle described below for cash. The cash price is shown below in Item (1) "Cash Price". He may also buy the V… …redit. The credit price is shown below in Item (11) "Deferred Payment Price". By signing this contract, the Buyer chooses to buy the V… …redit under the agreements in this contract. In this contract there is no promise as to the merchantability, suitability, or fitness for… …of the Vehicle. The Buyer may receive a separate warranty on the Vehicle.

…w or Used	Year and Make	Series	Body Style	No. Cyl.	If Truck Ton Capacity	Vehicle Identification Number	Use For Which Purchased
NEW	1981 MERCURY	CAPRI	3 DR	4		1MEBP67A8BF611351	☒ Personal ☐ Agr… ☐ Business ☐

…uding.
…adio ☐ Air Conditioner ☐ Automatic Transmission ☒ Power Steering ☐ Power Brakes ☐ Power Seats ☐ Power Windows ☐ ____________

…SCRIPTION OF TRADE-IN:
n.a. (Year and Make) n.a. (Serial Number) $ n.a. (Gross Allowance) $ n.a. (Amount Owing)

ADDITIONAL PROVISIONS

…Vehicle Ownership, Use and Care: The Buyer will take care of the Vehicle and will obey all laws in using it. The Buyer will not sell the Vehicle and will keep it free from the claims of other persons. The Buyer will use the Vehicle only in the state where he now lives unless the Creditor gives him written consent to use it in another state or unless his use of the Vehicle in another state is for no more than one month.

. Vehicle Insurance: The Buyer will insure the Buyer and the Creditor against loss or damage to the Vehicle. The type and amount of insurance must be acceptable to the Creditor. The Creditor may buy the insurance if the Buyer does not, but the Creditor does not have to do so. If the Creditor buys the insurance, the Creditor may insure only the Creditor or both the Creditor and the Buyer. In either case, the Buyer must pay back to the Creditor what the Creditor pays for the insurance plus interest at the highest rate allowed by law. If the Creditor insures only the Creditor, the Buyer will not have insurance. Whether or not the Vehicle is insured, the Buyer must pay for it if it is lost, damaged or destroyed.

If a charge for insurance is shown below, the Creditor will try to buy the coverages checked for the term shown. The Creditor is not liable though if he cannot do so. Coverages will be based on the cash value at the time of loss but not more than the limits of the policy. If these coverages cost more than the amount shown for insurance, the Creditor may buy them for a shorter term or he may credit the Buyer for the amount shown for insurance. If the Creditor cannot buy any insurance, he will credit the Buyer for the amount shown for insurance. The credit will be made to the last payments due, if allowed by law. If the Creditor does not buy the insurance, the Buyer must buy it.

- ☐ Comprehensive
- ☐ Fire-Theft & Combined Additional Coverage
- ☐ Towing & Labor Costs ($25.00 Limit)
- ☐ $ ____________ Deductible Collision

Term: __________ Months $ n.a.

THE BUYER MAY CHOOSE THE PERSON THROUGH WHOM VEHICLE INSURANCE IS TO BE OBTAINED.

. Credit and Other Optional Insurance:
(1) Credit Life Insurance by

DETAILS OF TRANSACTION

(a) Price $ 7729.00 +	(b) Sales Tax $ 386.45	Cash Price =$ 8115.45
(c) Trade-in (Description above) $ n.a. +	(d) Cash Downpayment $ 2450.00	Total Downpaym… =$ 2450.00
(e) Adjusted Price ((a) minus (c)) $ 7729.00		Unpaid Balance of Cash Pric… (Item (1) minus (2)) $ 5665.45

(4) Other Charges

Vehicle Insurance	$ n.a.
Credit Life Insurance	$ n.a.
Credit Disability Insurance	$ n.a.
Official Fees	$ n.a.
Taxes (Not in Cash Price)	$ 19.75
License ($ n.a.), Title ($ 5.00), and Registration ($ 33.50) Fees	$ 38.50
SERVICE CONTRACT	$ 395.00
	$ n.a.
	$ n.a.

Total Other Charges $ 453.25 (4

(5) Unpaid Balance – Amount Financed (Items (3) plus (4)) $ 6118.70 (5

(6) **FINANCE CHARGE** $ 4282.90 (6

(7) **ANNUAL PERCENTAGE RATE** 28.98 % (7)

(8) Total of Payments (Items (5) plus (6)) $ 10401.60 (8,

(9) Payment Schedule: The Buyer will pay the Total of Payments (Item 8) to the Creditor in 48 monthly payments. Each payment, except the last one will be $ 216.7 . The last payment will be $ 216.7 . Payments are due on the 17 day of each month. The first payment is due on OCT 17 1981 , 19 ______.

EXHIBIT F

of this contract. Its amount
is not more than the limits of
the policy shown in a notice
or agreement given to the
Buyer on this date. $ ______ n.a.

(2) **Credit Disability Insurance** by
____
on ____________________________
This insurance is for the term
of this contract. Its amount
is not more than the limits of
the policy shown in a notice
or agreement given to the
Buyer on this date. $ ______ n.a.

(3) **Other Optional Insurance** (Describe)
______________________ $ ______ n.a.
______________________ $ ______ n.a.

**REDIT LIFE INSURANCE, CREDIT DISABILITY
ISURANCE AND OTHER OPTIONAL INSUR-
NCE IS NOT REQUIRED BY THE CREDITOR
ID IS NOT A FACTOR IN THE CREDITOR'S
ECISION TO APPROVE THIS CREDIT.**

THIS DOES NOT INCLUDE INSURANCE ON YOUR LIABILITY FOR BODILY INJURY OR PROPERTY DAMAGE. WITHOUT SUCH INSURANCE, YOU MAY NOT OPERATE THIS VEHICLE ON PUBLIC HIGHWAYS.

he Buyer asks the Creditor to buy the insurance for
hich an amount is shown above.

Buyer Signs ______________________ Date ________

____

(Cost of insurance to be included only if signed by each insured Buyer and dated)

... payment is one that is more than ...
equal payment. A balloon payment may be refinanced when it be
only under such arrangements as the Creditor may approve.

(11) **Deferred Payment Price** (items (1) plus (4) plus (6)) $ 12051

(12) **Security Interest:** The Buyer gives the Creditor a security interest
Uniform Commercial Code in the Vehicle, in all money or goods recei
Vehicle and in all insurance charges financed for the Buyer. This se
payment of the monthly payments and all other amounts the Buy
later owes on this contract. It also secures the Buyer's other agre
this contract.

(13) **Prepayment Rebate:** The Buyer may pay this contract in full at
If he does so, he will get a credit for the unearned part of the Financ
if it is $1.00 or more. This credit will be figured on the sum of t
method after first subtracting $15.00.

(14) **Late Charges:** The Buyer will pay a late charge on each payment r
within 10 days after it is due. The charge is 5 per cent of the part of
ment that is late or $5.00, whichever is less. The Buyer also will pay
paid by the Creditor to collect any late payment as allowed by l
Creditor's acceptance of any late payment or late charge does not ex
Buyer's default or mean that the Buyer can keep making payments af
are due. The Creditor may accelerate the remaining payments and re
the Vehicle, as explained below, if there is any default.

(15) **Default:** If the Buyer fails to make any payment when it is due, or if
to keep any other agreement in this contract, the Creditor may do e
both of the following:

a. **Acceleration of Payments:** The Creditor may require the Buyer
at once all remaining payments. The Buyer will receive a prepayment
as explained above when he pays.

b. **Repossession:** The Creditor may repossess the Vehicle. The Cr
may also take goods found in or on the Vehicle and hold them f
Buyer. If the Vehicle is taken back, the Creditor will send a notice
Buyer. The notice will state that the Buyer may redeem (buy bac
Vehicle. It will also show the amount needed to redeem. The Buye
redeem the Vehicle up to the time the Creditor sells it or agrees to
If the Buyer does not redeem the Vehicle, it will be sold. The money
the sale, less allowed expenses, will be used to pay the amount stil
on this contract. Allowed expenses are those paid as a direct res
having to retake the Vehicle, hold it, prepare it for sale and sell it. Law
fees and legal costs are allowed too. The lawyers' fees will not be
than 20% of the first $500.00 and 10% on the rest owed on this con
If there is any money left (a surplus), it will be paid to the Buyer. If the m
from the sale is not enough to pay off this contract and costs, the B
will pay what is still owed to the Creditor.

(16) **General:** Any change in this contract must be in writing and signed by
Buyer and the Creditor. The law of New Jersey applies to this contract. If tha
does not allow all of the agreements in this contract, the ones that are
allowed will be void. The rest of this contract will still be good.

NOTICE TO RETAIL BUYER

**Do not sign this contract in blank.
You are entitled to a copy of the contract at the time you sign.
Keep it to protect your legal rights.**

uyer acknowledges receipt of a true and completely filled in copy of this contract at the time of signing.

(Buyer) Signs [redacted] ______ (Co) Buyer Signs ______________________

ssignment: The Seller accepts this contract. If no other Assignee is named at the top of this contract the Seller assigns it to Ford Motor Cred
ompany under the Assignment on the back of this contract. If another Assignee is named, the Seller assigns this contract to the other name
signee under the Assignment attached to this contract. When the Assignee buys this contract, it will be the Creditor.

Seller Signs COMPASS LINCOLN MERCURY ______________ By ______________________ Title ______________________

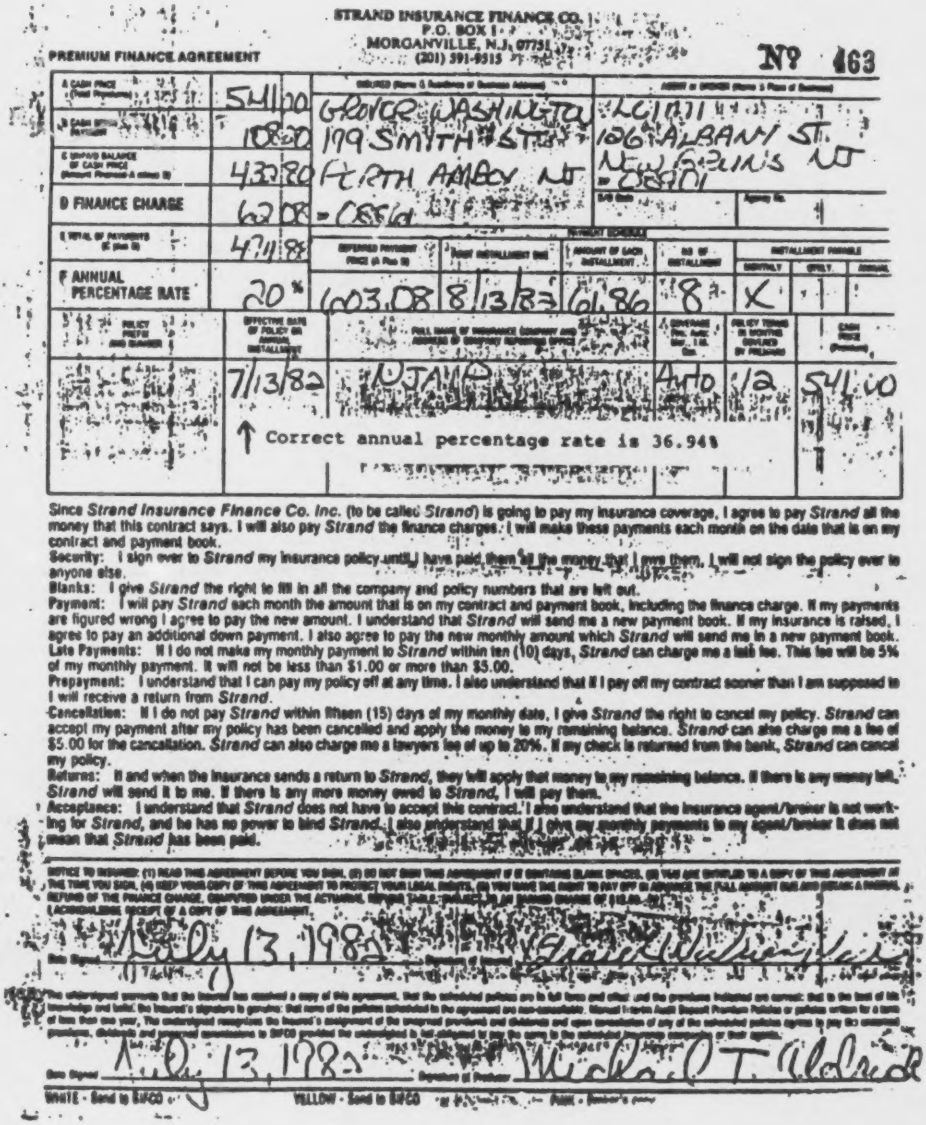
NOTICE – ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

EC 10025 Jun 76

BUYER'S COPY

EXHIBIT F

EXHIBIT C



STRAND INSURANCE FINANCE CO.
P.O. BOX 1
MORGANVILLE, N.J. 07751
(201) 591-9315

PREMIUM FINANCE AGREEMENT

No 463

A CASH PRICE (Total Premiums)	541.00	INSURED (Name & Residence or Business Address)	AGENT or BROKER (Name & Place of Business)
B CASH DOWN PAYMENT	108.20	GROVER WASHINGTON 179 SMITH ST. PERTH AMBOY NJ 08861	[illegible] 126 ALBANY ST. NEW BRUNS NJ 08901
C UNPAID BALANCE OF CASH PRICE (Amount Financed A minus B)	432.80		
D FINANCE CHARGE	62.08		
E TOTAL OF PAYMENTS (C plus D)	471.88		

PAYMENT SCHEDULE

DEFERRED PAYMENT PRICE (A Plus D)	FIRST INSTALLMENT DUE	AMOUNT OF EACH INSTALLMENT	NO. OF INSTALLMENTS	INSTALLMENT PAYABLE MONTHLY	QTLY.	ANNUAL
603.08	8/13/82	61.86	8	X		

F ANNUAL PERCENTAGE RATE 20%

POLICY PREFIX AND NUMBER	EFFECTIVE DATE OF POLICY OR ANNUAL INSTALLMENT	FULL NAME OF INSURANCE COMPANY AND ADDRESS OF COMPANY REPORTING OFFICE	COVERAGE	POLICY TERMS IN MONTHS COVERED BY PREMIUMS	CASH PRICE (Premium)
	7/13/82	NJAIUP	Auto	12	541.00

↑ Correct annual percentage rate is 36.94%

Since *Strand Insurance Finance Co. Inc.* (to be called *Strand*) is going to pay my insurance coverage, I agree to pay *Strand* all the money that this contract says. I will also pay *Strand* the finance charges. I will make these payments each month on the date that is on my contract and payment book.

Security: I sign over to *Strand* my insurance policy until I have paid them all the money that I owe them. I will not sign the policy over to anyone else.

Blanks: I give *Strand* the right to fill in all the company and policy numbers that are left out.

Payment: I will pay *Strand* each month the amount that is on my contract and payment book, including the finance charge. If my payments are figured wrong I agree to pay the new amount. I understand that *Strand* will send me a new payment book. If my insurance is raised, I agree to pay an additional down payment. I also agree to pay the new monthly amount which *Strand* will send me in a new payment book.

Late Payments: If I do not make my monthly payment to *Strand* within ten (10) days, *Strand* can charge me a late fee. This fee will be 5% of my monthly payment. It will not be less than $1.00 or more than $5.00.

Prepayment: I understand that I can pay my policy off at any time. I also understand that if I pay off my contract sooner than I am supposed to I will receive a return from *Strand*.

Cancellation: If I do not pay *Strand* within fifteen (15) days of my monthly date, I give *Strand* the right to cancel my policy. *Strand* can accept my payment after my policy has been cancelled and apply the money to my remaining balance. *Strand* can also charge me a fee of $5.00 for the cancellation. *Strand* can also charge me a lawyers fee of up to 20%. If my check is returned from the bank, *Strand* can cancel my policy.

Returns: If and when the insurance sends a return to *Strand*, they will apply that money to my remaining balance. If there is any money left, *Strand* will send it to me. If there is any more money owed to *Strand*, I will pay them.

Acceptance: I understand that *Strand* does not have to accept this contract. I also understand that the insurance agent/broker is not working for *Strand*, and he has no power to bind *Strand*. I also understand that if I give my monthly payments to my agent/broker it does not mean that *Strand* has been paid.

NOTICE TO INSURED: (1) READ THIS AGREEMENT BEFORE YOU SIGN, (2) DO NOT SIGN THIS AGREEMENT IF IT CONTAINS BLANK SPACES, (3) YOU ARE ENTITLED TO A COPY OF THIS AGREEMENT AT THE TIME YOU SIGN, (4) KEEP YOUR COPY OF THIS AGREEMENT TO PROTECT YOUR LEGAL RIGHTS, (5) YOU HAVE THE RIGHT TO PAY OFF IN ADVANCE THE FULL AMOUNT DUE AND OBTAIN A PARTIAL REFUND OF THE FINANCE CHARGE, COMPUTED UNDER THE ACTUARIAL METHOD TABLE, SUBJECT TO AN EARNED CHARGE OF $15.00. (6) I ACKNOWLEDGE RECEIPT OF A COPY OF THIS AGREEMENT.

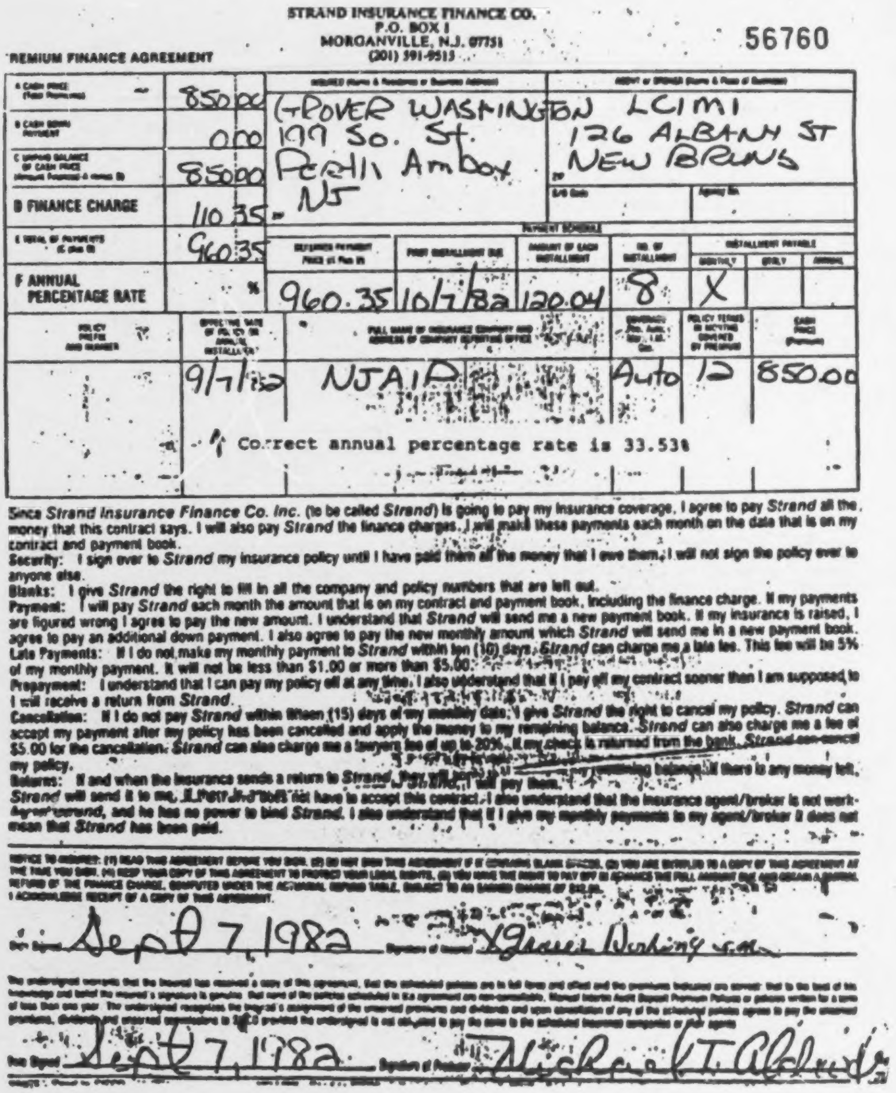
Date Signed July 13, 1982 Signature of Insured Grover Washington

The undersigned warrants that the Insured has received a copy of this agreement, that the scheduled policies are in full force and effect and the premiums indicated are correct; that to the best of his knowledge and belief, the Insured's signature is genuine; [illegible]

Date Signed July 13, 1982 Signature of Producer Michael T. Aldrich

WHITE - Send to SIFCO YELLOW - Send to SIFCO [illegible] PINK - Producer's copy

EXHIBIT D



STRAND INSURANCE FINANCE CO.
P.O. BOX I
MORGANVILLE, N.J. 07751
(201) 591-9515

56760

PREMIUM FINANCE AGREEMENT

A CASH PRICE	850.00	INSURED	AGENT or BROKER
B CASH DOWN PAYMENT	0.00	GROVER WASHINGTON 197 So. St. Perth Amboy NJ	LCIMI 126 ALBANY ST NEW BRUNS
C UNPAID BALANCE OF CASH PRICE	850.00		
D FINANCE CHARGE	110.35		
E TOTAL OF PAYMENTS (C plus D)	960.35		
F ANNUAL PERCENTAGE RATE	%		

PAYMENT SCHEDULE

DEFERRED PAYMENT PRICE	FIRST INSTALLMENT DUE	AMOUNT OF EACH INSTALLMENT	NO. OF INSTALLMENTS	INSTALLMENT PAYABLE MONTHLY	QTRLY	ANNUAL
960.35	10/7/82	120.04	8	X		

POLICY PREFIX AND NUMBER	EFFECTIVE DATE OF POLICY	FULL NAME OF INSURANCE COMPANY AND ADDRESS	COVERAGE	POLICY TERMS IN MONTHS COVERED BY PREMIUM	CASH PRICE (Premium)
	9/7/82	NJAIP	Auto	12	850.00

Correct annual percentage rate is 33.53%

Since *Strand Insurance Finance Co. Inc.* (to be called *Strand*) is going to pay my insurance coverage, I agree to pay *Strand* all the money that this contract says. I will also pay *Strand* the finance charges. I will make these payments each month on the date that is on my contract and payment book.

Security: I sign over to *Strand* my insurance policy until I have paid them all the money that I owe them. I will not sign the policy over to anyone else.

Blanks: I give *Strand* the right to fill in all the company and policy numbers that are left out.

Payment: I will pay *Strand* each month the amount that is on my contract and payment book, including the finance charge. If my payments are figured wrong I agree to pay the new amount. I understand that *Strand* will send me a new payment book. If my insurance is raised, I agree to pay an additional down payment. I also agree to pay the new monthly amount which *Strand* will send me in a new payment book.

Late Payments: If I do not make my monthly payment to *Strand* within ten (10) days, *Strand* can charge me a late fee. This fee will be 5% of my monthly payment. It will not be less than $1.00 or more than $5.00.

Prepayment: I understand that I can pay my policy off at any time. I also understand that if I pay off my contract sooner than I am supposed to I will receive a return from *Strand*.

Cancellation: If I do not pay *Strand* within fifteen (15) days of my monthly date, I give *Strand* the right to cancel my policy. *Strand* can accept my payment after my policy has been cancelled and apply the money to my remaining balance. *Strand* can also charge me a fee of $5.00 for the cancellation. *Strand* can also charge me a lawyers fee of up to 20%. If my check is returned from the bank, *Strand* can cancel my policy.

Balance: If and when the insurance sends a return to *Strand*, they will apply it to my remaining balance. If there is any money left, *Strand* will send it to me. [illegible] to *Strand*, I will pay them. [illegible] not have to accept this contract. I also understand that the insurance agent/broker is not working for *Strand*, and he has no power to bind *Strand*. I also understand that if I give my monthly payments to my agent/broker it does not mean that *Strand* has been paid.

[illegible]

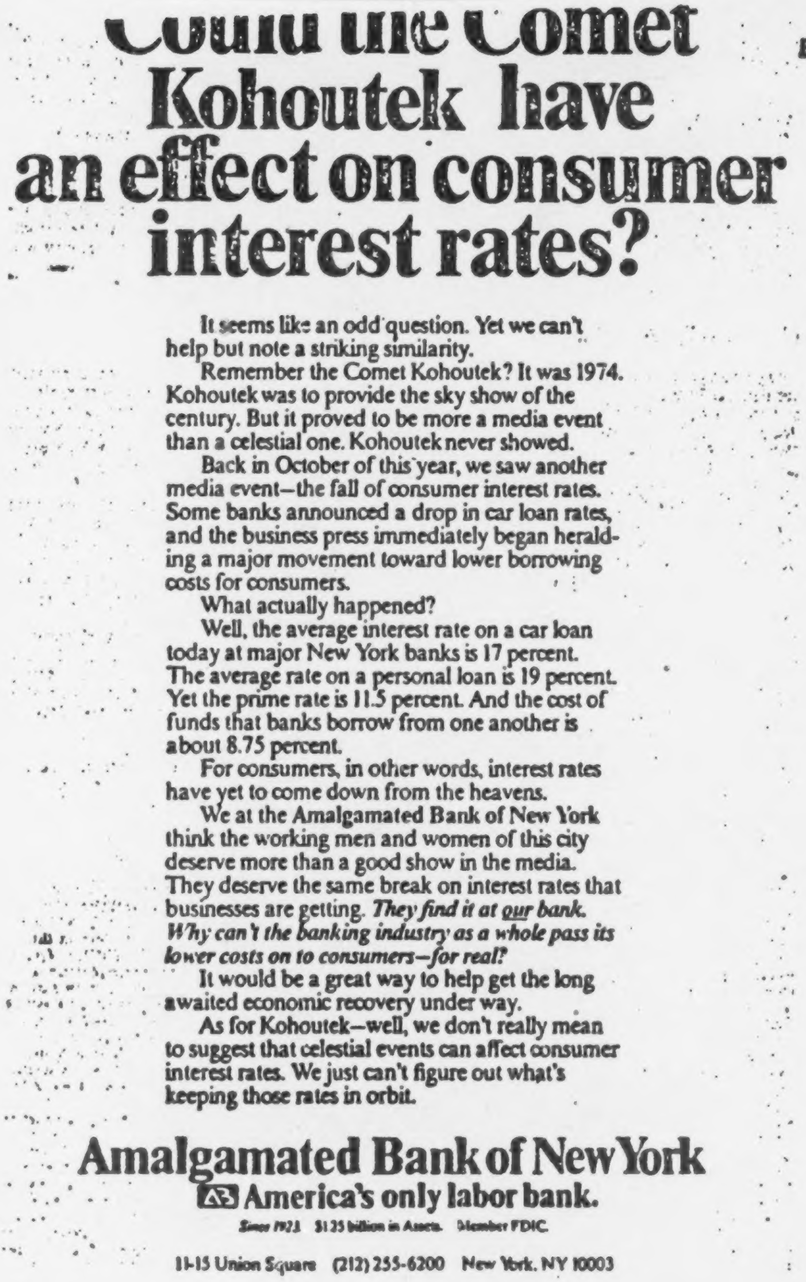
I ACKNOWLEDGE RECEIPT OF A COPY OF THIS AGREEMENT.

Date Signed Sept 7, 1982 Signature of Insured X Grover Washington

[illegible]

Date Signed Sept 7, 1982 Signature of Producer Michael T. Al[illegible]

EXHIBIT L



Could the Comet Kohoutek have an effect on consumer interest rates?

It seems like an odd question. Yet we can't help but note a striking similarity.

Remember the Comet Kohoutek? It was 1974. Kohoutek was to provide the sky show of the century. But it proved to be more a media event than a celestial one. Kohoutek never showed.

Back in October of this year, we saw another media event—the fall of consumer interest rates. Some banks announced a drop in car loan rates, and the business press immediately began heralding a major movement toward lower borrowing costs for consumers.

What actually happened?

Well, the average interest rate on a car loan today at major New York banks is 17 percent. The average rate on a personal loan is 19 percent. Yet the prime rate is 11.5 percent. And the cost of funds that banks borrow from one another is about 8.75 percent.

For consumers, in other words, interest rates have yet to come down from the heavens.

We at the Amalgamated Bank of New York think the working men and women of this city deserve more than a good show in the media. They deserve the same break on interest rates that businesses are getting. *They find it at our bank. Why can't the banking industry as a whole pass its lower costs on to consumers—for real?*

It would be a great way to help get the long awaited economic recovery under way.

As for Kohoutek—well, we don't really mean to suggest that celestial events can affect consumer interest rates. We just can't figure out what's keeping those rates in orbit.

Amalgamated Bank of New York
America's only labor bank.
Since 1923 $1.25 billion in Assets. Member FDIC

11-15 Union Square (212) 255-6200 New York, NY 10003

New York Times, Jan. 10, 1983

EXHIBIT M

WHAT ARE NEW YORK BANKS CHARGING ON CASH ADVANCES?

Bank	Account	Periodic Interest	Service Charge	Annual Fee	Effective Date
Bank of New York	Visa/MC	19.8% (9/1/82)	0	$12	12/1/82
Chase Manhattan	Visa	18%	$.25	$15	3/1/82
Citibank	Ready Credit	20%/18%[1]	0	0	10/9/81
Citibank	Visa	19.8%	.25	$20 (3/2/82)	1/19/81
Chemical	MC	19.5%	.75	$20 (12/1/82)	2/1/82
EAB	Visa/MC	19.68%	.25	$15/0[1]	10/1/82
Manufacturers Hanover Trust	MC	19.8%	0[2]	$15	3/1/82

Notes:
1. The lower rates apply to persons maintaining low interest savings and/or checking account(s) with the bank.
2. Manufacturers Hanover Trust formerly imposed a $.25 service charge, but discontinued it on 3/1/82.
3. In general, most of these banks offer both Visa and Mastercard with identical terms.
4. These cash advances are made through the above credit cards. This survey was taken at the end of November 1982.

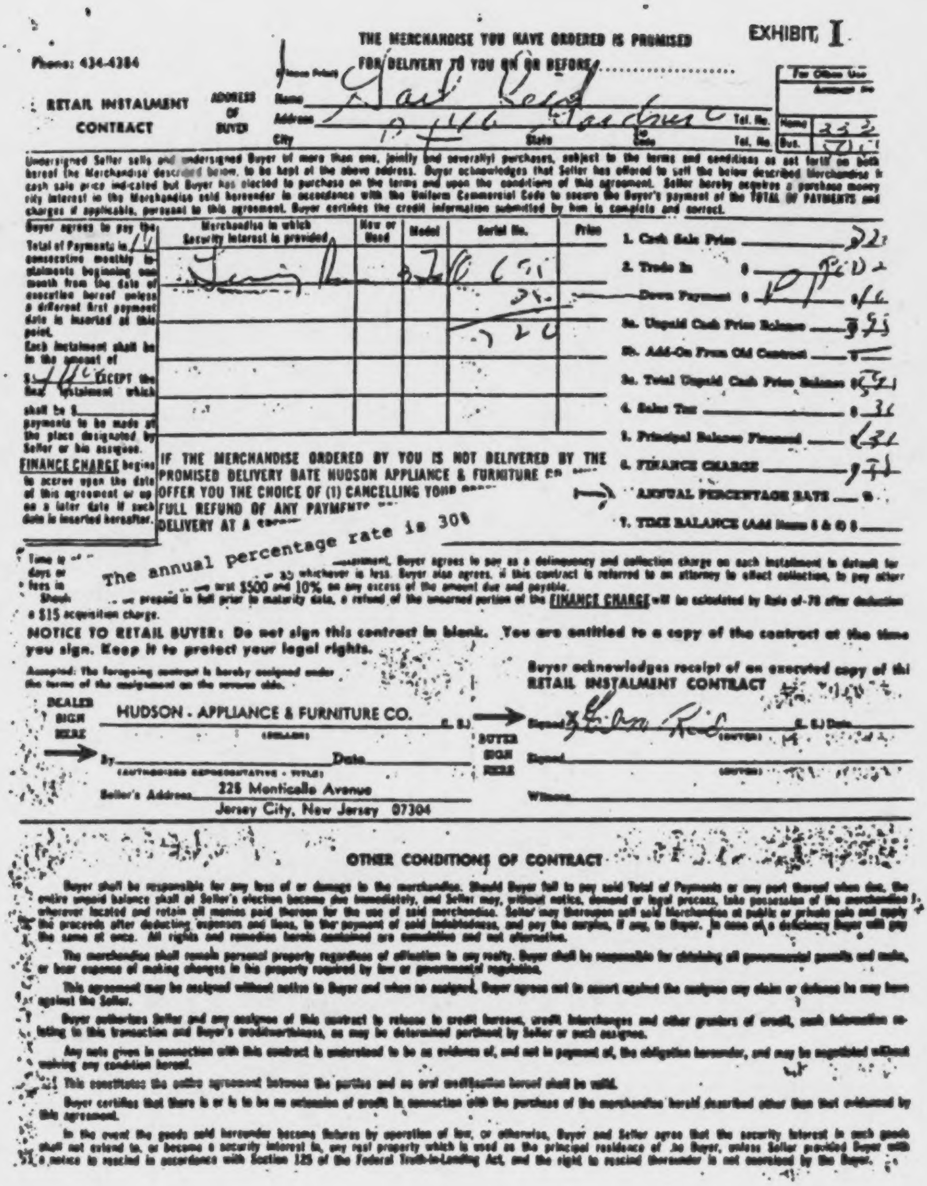


EXHIBIT I

THE MERCHANDISE YOU HAVE ORDERED IS PROMISED FOR DELIVERY TO YOU ON OR BEFORE..................

Phone: 434-4384

RETAIL INSTALMENT CONTRACT

ADDRESS OF BUYER

(Please Print) Name Gail Reid
Address [illegible] Tel. No.
City [illegible] State Zip Code Tel. No.

For Office Use
Account No.
Home [illegible]
Bus. [illegible]

Undersigned Seller sells and undersigned Buyer (if more than one, jointly and severally) purchases, subject to the terms and conditions as set forth on both hereof the Merchandise described below, to be kept at the above address. Buyer acknowledges that Seller has offered to sell the below described Merchandise for cash sale price indicated but Buyer has elected to purchase on the terms and upon the conditions of this agreement. Seller hereby acquires a purchase money security interest in the Merchandise sold hereunder in accordance with the Uniform Commercial Code to secure the Buyer's payment of the TOTAL OF PAYMENTS and charges if applicable, pursuant to this agreement. Buyer certifies the credit information submitted by him is complete and correct.

Buyer agrees to pay the Total of Payments in [illegible] consecutive monthly instalments beginning one month from the date of execution hereof unless a different first payment date is inserted at this point.
Each instalment shall be in the amount of $ [illegible] EXCEPT the final instalment which shall be $ ______ payments to be made at the place designated by Seller or his assignee.
FINANCE CHARGE begins to accrue upon the date of this agreement or upon a later date if such date is inserted hereafter.

Merchandise in which Security Interest is provided	New or Used	Model	Serial No.	Price
[illegible]		[illegible]	[illegible]	
			[illegible]	
			[illegible]	

1. Cash Sale Price ______ [illegible]
2. Trade In $ ______ [illegible]
Down Payment $ ______ [illegible]
3a. Unpaid Cash Price Balance ______ [illegible]
3b. Add-On From Old Contract ______
3c. Total Unpaid Cash Price Balance $ [illegible]
4. Sales Tax ______ $ [illegible]
5. Principal Balance Financed ______ [illegible]
6. FINANCE CHARGE ______ [illegible]
ANNUAL PERCENTAGE RATE ______ %
7. TIME BALANCE (Add Items 5 & 6) $ ______

IF THE MERCHANDISE ORDERED BY YOU IS NOT DELIVERED BY THE PROMISED DELIVERY DATE HUDSON APPLIANCE & FURNITURE CO. [illegible] OFFER YOU THE CHOICE OF (1) CANCELLING YOUR [illegible] FULL REFUND OF ANY PAYMENTS [illegible] DELIVERY AT A [illegible]

The annual percentage rate is 30%

Time is [illegible] instalment, Buyer agrees to pay as a delinquency and collection charge on each instalment in default for [illegible] days or [illegible] $5 whichever is less. Buyer also agrees, if this contract is referred to an attorney to effect collection, to pay attorney fees in [illegible] first $500 and 10% on any excess of the amount due and payable.
Should [illegible] prepaid in full prior to maturity date, a refund of the unearned portion of the FINANCE CHARGE will be calculated by Rule of 78 after deduction of a $15 acquisition charge.

NOTICE TO RETAIL BUYER: Do not sign this contract in blank. You are entitled to a copy of the contract at the time you sign. Keep it to protect your legal rights.

Accepted: The foregoing contract is hereby assigned under the terms of the assignment on the reverse side.

Buyer acknowledges receipt of an executed copy of this RETAIL INSTALMENT CONTRACT

DEALER SIGN HERE
HUDSON - APPLIANCE & FURNITURE CO. (L. S.)
(DEALER)
By ______ Date ______
(AUTHORIZED REPRESENTATIVE - TITLE)
Seller's Address 225 Monticello Avenue
Jersey City, New Jersey 07304

BUYER SIGN HERE
Signed ______ (L. S.) Date ______
(BUYER)
Signed ______
(BUYER)
Witness ______

OTHER CONDITIONS OF CONTRACT

Buyer shall be responsible for any loss of or damage to the merchandise. Should Buyer fail to pay said Total of Payments or any part thereof when due, the entire unpaid balance shall at Seller's election become due immediately, and Seller may, without notice, demand or legal process, take possession of the merchandise wherever located and retain all monies paid thereon for the use of said merchandise. Seller may thereupon sell said Merchandise at public or private sale and apply the proceeds after deducting expenses and liens, to the payment of said indebtedness, and pay the surplus, if any, to Buyer. In case of a deficiency Buyer will pay the same at once. All rights and remedies herein contained are cumulative and not alternative.

The merchandise shall remain personal property regardless of affixation to any realty. Buyer shall be responsible for obtaining all governmental permits and visits, or bear expense of making changes in his property required by law or governmental regulation.

This agreement may be assigned without notice to Buyer and when so assigned, Buyer agrees not to assert against the assignee any claim or defense he may have against the Seller.

Buyer authorizes Seller and any assignee of this contract to release to credit bureaus, credit interchanges and other grantors of credit, such information relating to this transaction and Buyer's creditworthiness, as may be determined pertinent by Seller or such assignee.

Any note given in connection with this contract is understood to be as evidence of, and not in payment of, the obligation hereunder, and may be negotiated without waiving any condition hereof.

This constitutes the entire agreement between the parties and no oral modification hereof shall be valid.

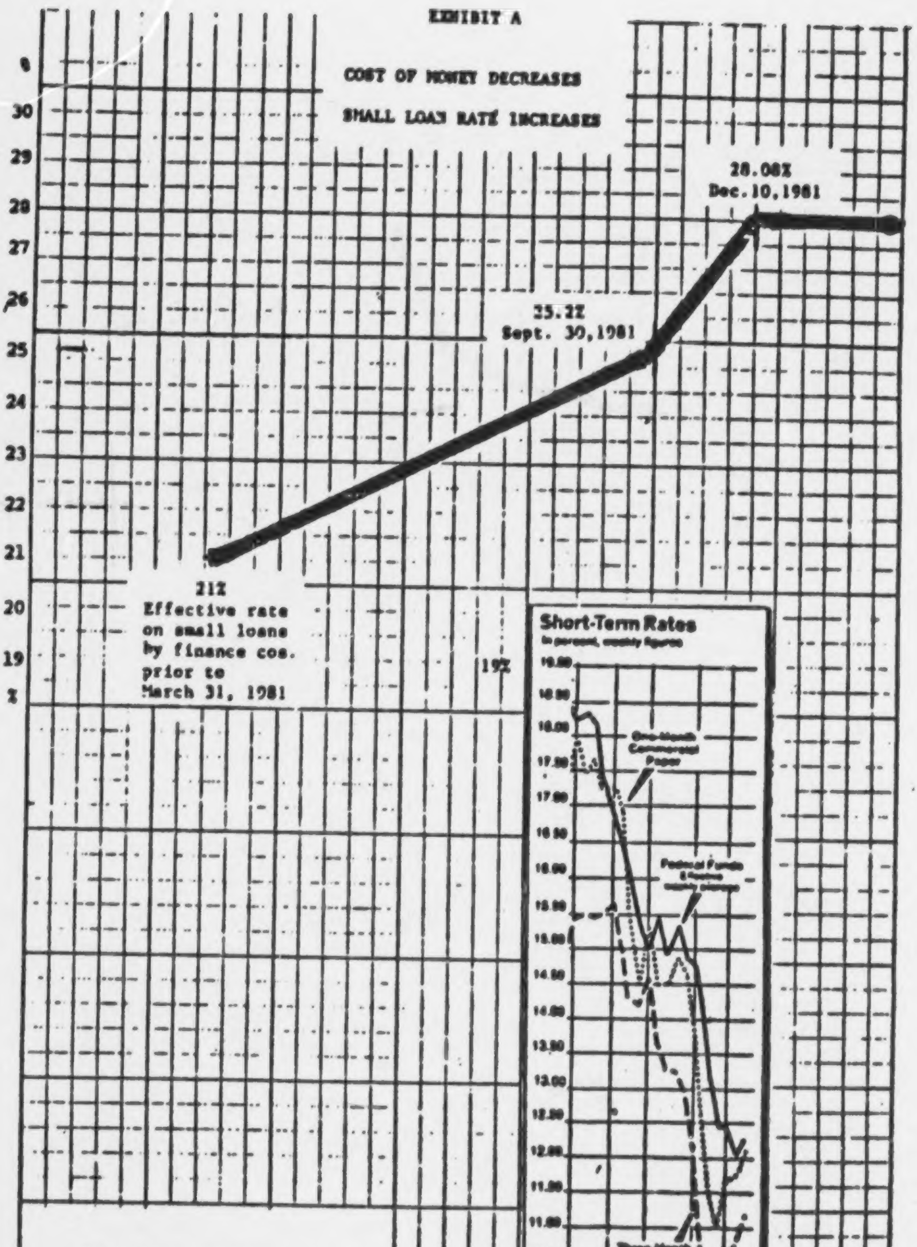
Buyer certifies that there is or is to be no extension of credit in connection with the purchase of the merchandise herein described other than that evidenced by this agreement.

In the event the goods sold hereunder become fixtures by operation of law, or otherwise, Buyer and Seller agree that the security interest in such goods shall not extend to, or become a security interest in, any real property which is used as the principal residence of the Buyer, unless Seller provided Buyer with a notice to rescind in accordance with Section 125 of the Federal Truth-in-Lending Act, and the right to rescind thereunder is not exercised by the Buyer.

EXHIBIT A

COST OF MONEY DECREASES

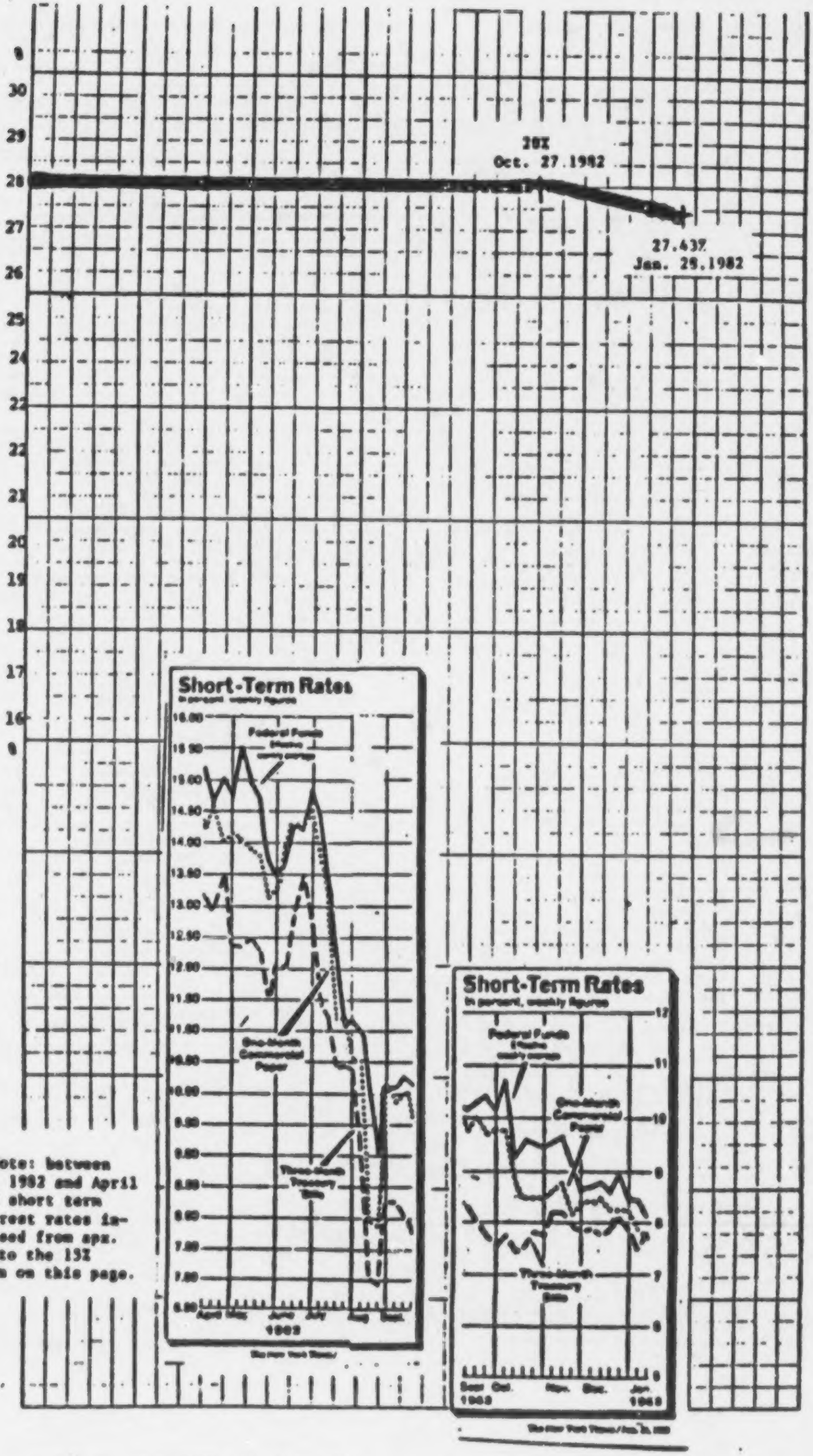
SMALL LOAN RATE INCREASES



Interest rates are plotted on the vertical axis: time is the horizontal axis. The average interest rate at the finance companies surveyed is given. On three out of the four dates surveyed, at least one finance company was charging 36%.

Due to space limitations, the upper part of the graph is not the same scale as the bottom part. If the scale were the same, the small loan rate would go above the top of the page.

EXHIBIT A, page 2



28%
Oct. 27.1982

27.43%
Jan. 28.1982

Note: between Jan. 1982 and April 1982 short term interest rates increased from apx. 12% to the 15% shown on this page.

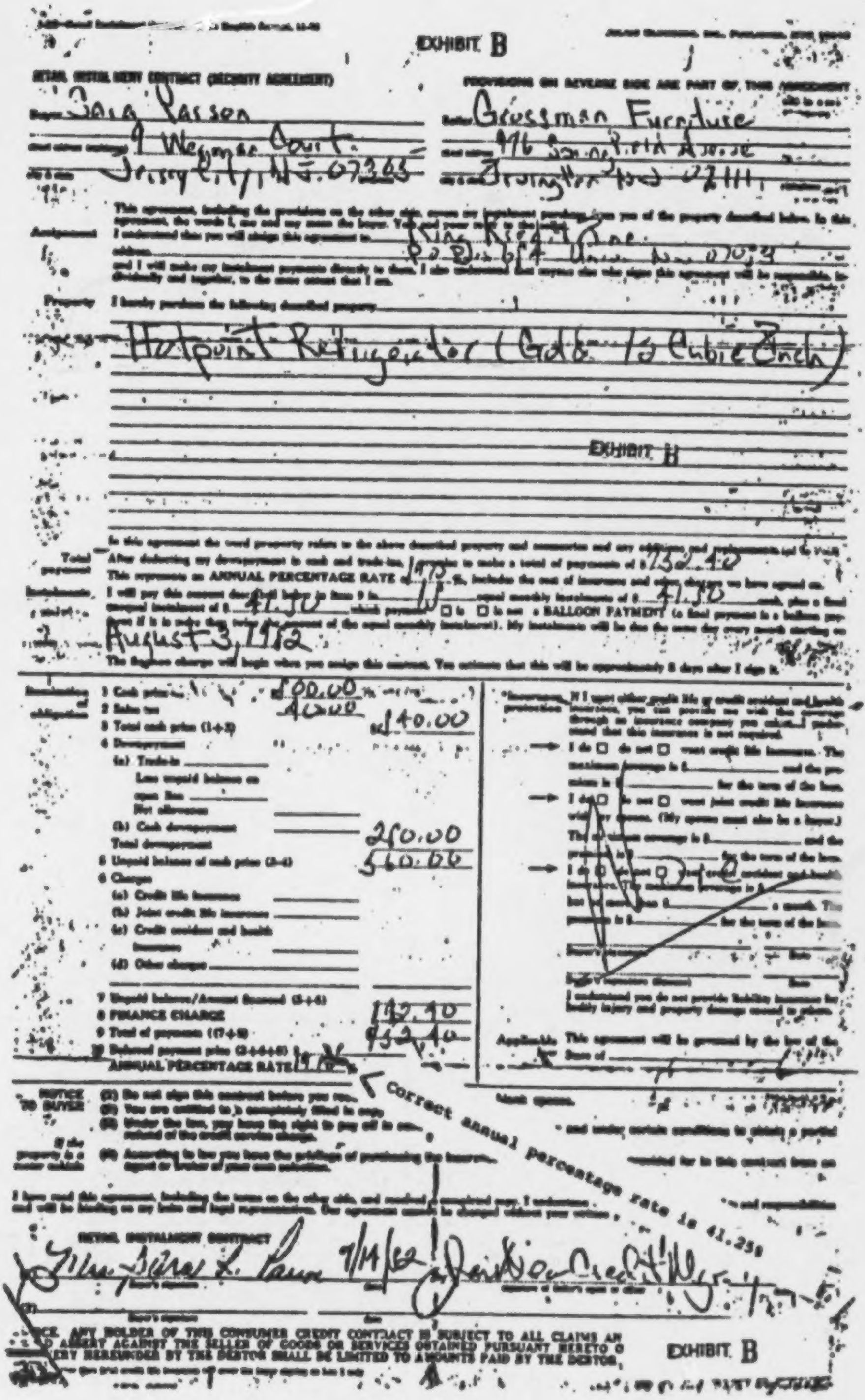


EXHIBIT B

RETAIL INSTALLMENT CONTRACT (SECURITY AGREEMENT)

PROVISIONS ON REVERSE SIDE ARE PART OF THIS AGREEMENT

Buyer: Sara Passon
9 Weymar Court
Jersey City, N.J. 07305

Seller: Grossman Furniture
496 Springfield Avenue
Irvington N.J. 07111

This agreement, including the provisions on the other side, covers my installment purchase from you of the property described below. In this agreement, the words I, me and my mean the buyer.

Assignment: I understand that you will assign this agreement to King Kredit Inc.
address P.O. Box 614 Union N.J. 07083
and I will make my installment payments directly to them.

Property: I hereby purchase the following described property
Hotpoint Refrigerator (Gold 13 Cubic Inch)

EXHIBIT B

Total payment: After deducting my downpayment in cash and trade-ins, I promise to make a total of payments of $752.40
This represents an ANNUAL PERCENTAGE RATE of 19.75%
Installments: I will pay this amount in 17 equal monthly installments of $41.80 each, plus a final unequal installment of $41.80 which payment ☐ is ☐ is not a BALLOON PAYMENT. My installments will be due the same day every month starting on August 3, 1972

1 Cash price	$500.00	
2 Sales tax	40.00	
3 Total cash price (1+2)		$540.00
4 Downpayment		
(a) Trade-in		
Less unpaid balance on open lien		
Net allowance		
(b) Cash downpayment		
Total downpayment		250.00
5 Unpaid balance of cash price (3-4)		560.00
6 Charges		
(a) Credit life insurance		
(b) Joint credit life insurance		
(c) Credit accident and health insurance		
(d) Other charges		
7 Unpaid balance/Amount financed (5+6)		
8 FINANCE CHARGE		192.40
9 Total of payments (7+8)		752.40
10 Deferred payment price (3+4+8)		
ANNUAL PERCENTAGE RATE	19.75%	

Insurance protection: I do ☐ do not ☐ want credit life insurance.
I do ☐ do not ☐ want joint credit life insurance
I do ☐ do not ☐ want credit accident and health insurance.

I understand you do not provide liability insurance for bodily injury and property damage caused to others.

Applicable law: This agreement will be governed by the law of the State of

NOTICE TO BUYER

< Correct annual percentage rate is 41.25%

RETAIL INSTALLMENT CONTRACT

Mrs. Sara L. Passon 7/14/72

NOTICE. ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AN
ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO O
ERY HEREUNDER BY THE DEBTOR SHALL BE LIMITED TO AMOUNTS PAID BY THE DEBTOR.

EXHIBIT B

EXHIBIT E

SECONDARY MORTGAGE LOAN

This promissory note is subject to the provisions of the Secondary Mortgage Loan Act.

NOTE AND FEDERAL DISCLOSURE STATEMENT

LENDER:

FIRST MUTUAL CORP 5575 S US HY 130 PENN NJ 08110

2096-2	10		HOME-SEC-RE	MISC	11-10-81	[illegible]
SEPH P FRANCIS	ANICE	25187.28	FINANCE CHARGE		NONE	36950.40
3 PENNSYLVANIA AVE	ANNUAL PERCENTAGE RATE	NONE	1463.24	NONE	[illegible]	1763.12
LONIA NJ — 07067	29.74	307.92	119	307.92	12-10-81	11-10-91
[illegible]					1-10-81	[illegible]

The Finance Charge made on this loan will begin to accrue on

For Value Received, the undersigned jointly and severally promise to pay to the order of Lender named above, at the Lender's said office, the Amount Financed shown above, together with interest on unpaid principal balances at the Annual Percentage Rate shown above, all of which is payable in successive monthly installments and the Number and Amount of said installments are shown above. The first of said installments is payable on the First Due Date shown herein and each subsequent installment on the same day of each succeeding month thereafter, the final installment being due and payable on the Final Due Date shown above. Each installment shall be in the amount of installment shown above if this note is paid according to contract, otherwise, the final installment shall be equal to the unpaid principal plus interest accrued and unpaid at the time said final installment is paid. If this note is not paid at maturity, the unpaid principal balance thereof shall bear interest thereafter at said rate of interest.

A default in the payment of the full amount of any installment of the principal and interest thereon, at the option of the holder hereof and without notice or demand, shall render the entire unpaid balance of the principal hereof and accrued interest thereon at once due and payable. Payment in advance may be made hereon in any amount at any time. All payments made hereon shall be applied first to interest to date of payment and the remainder then to principal.

In the event it becomes necessary for the Lender to refer this note to an Attorney-at-Law of the State of New Jersey for collection and suit actually is filed by such attorney resulting in a decision in favor of said Lender, the undersigned agree to pay attorney's fees equal to 15% of the first $500.00 of the judgment, 10% of the next $500.00 and 5% of any amount in excess of $1,000.00. It is understood and agreed that in the event of a default in any of the terms and conditions herein set forth, the holder of this Note shall have the right to institute suit for the recovery of the unpaid balance due together with interest without first resorting to any security.

SECURITY:

The principal security for this loan shall be a Second Mortgage on Real Property owned by the Borrowers which property shall be the residence of the Borrowers shown herein unless identified below.

Location of Real Property Other Than Borrower's Residence:

Address

City County

☐ ACCOMMODATION MAKER

At the direction and request of the Borrowers, on their behalf and for their benefit, the following disbursements have been made, from the Amount Financed.

AMOUNT FINANCED		$ 11,763.12
Credit Life Premium $ 1463.24 Credit Disability Prem. $ none	$ 11463.24	
Legal Fees	$ 300.00	
LESS TOTAL OF INSURANCE PREMIUMS AND FEES		$ 1763.24
PROCEEDS OF LOAN AVAILABLE TO BORROWER		$ 9,000.00
Balance due after refunds and credits on Prior Account No. shown above	$ 0	
Check Payable to Borrower JOSEPH P & JANICE FRANCIS	$ 88787.04	
Check Payable to FIRST NATIONAL BANK OF COLONIA	$ 11212.04	
Check Payable to	$	
Check Payable to	$	
Check Payable to	$	
Check Payable to	$	
Check Payable to	$	
Check Payable to	$	
Check Payable to	$	
TOTAL DISBURSEMENTS OF PROCEEDS OF LOAN AVAILABLE TO BORROWER		$ 9,999.00

CREDIT INSURANCE. Credit life insurance and credit disability insurance are not required in connection with this loan and were not a factor in the approval of the extension of credit. If Debtor chose to obtain credit insurance through Lender for the term of the loan, as indicated on the separately signed and dated Insurance Notice to Applicant, the cost(s) thereof are shown in the appropriate space(s) above and are included in the Amount Financed.

The undersigned acknowledge receipt of a copy of Note and Federal Disclosure Statement as respectively prescribed by the Federal Consumer Credit Protection Act and Regulation Z issued thereunder and further agree that the proceeds of loan were received on the date shown below and were disbursed in accordance with the undersigned's authorization, for the items shown above.

NOTICE TO BORROWER

Read this promissory note before you sign.
Do not sign this promissory note if it contains any blank spaces.
This promissory note is secured by a second mortgage on your real property.

ATTORNEY-AT-LAW OF NJ

Date 11-10-81

X

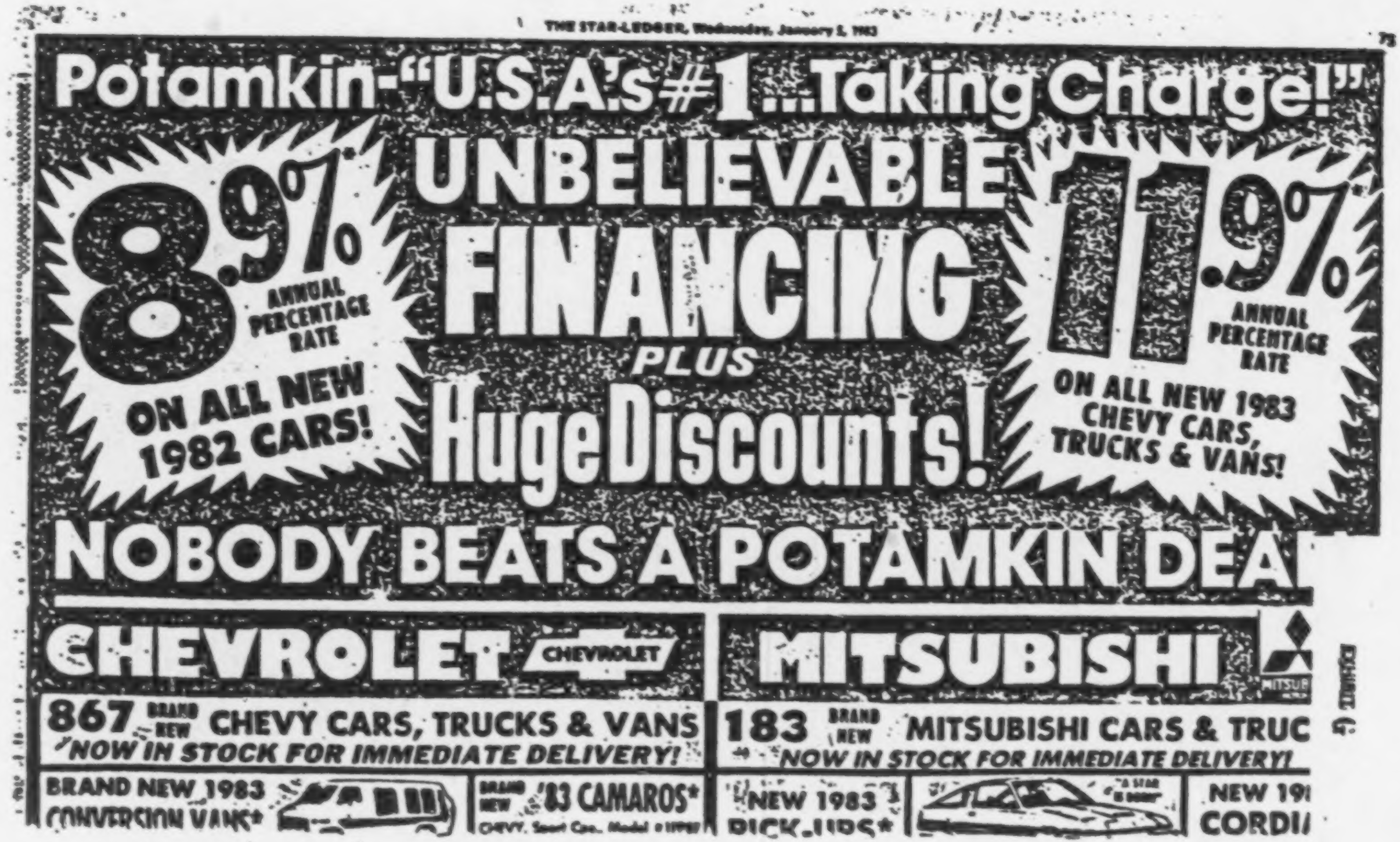
BORROWER/MORTGAGOR

JOSEPH P FRANCIS

X Janice Francis

BORROWER/MORTGAGOR

EXHIBIT G



THE STAR-LEDGER, Wednesday, January 5, 1983

73

Potamkin-"U.S.A.'s #1 ...Taking Charge!"

8.9% ANNUAL PERCENTAGE RATE

ON ALL NEW 1982 CARS!

UNBELIEVABLE FINANCING PLUS Huge Discounts!

11.9% ANNUAL PERCENTAGE RATE

ON ALL NEW 1983 CHEVY CARS, TRUCKS & VANS!

NOBODY BEATS A POTAMKIN DEA

CHEVROLET

867 BRAND NEW CHEVY CARS, TRUCKS & VANS

NOW IN STOCK FOR IMMEDIATE DELIVERY!

BRAND NEW 1983 CONVERSION VANS*

BRAND NEW '83 CAMAROS*

CHEVY, Sport Cpe., Model #1FP87

MITSUBISHI

183 BRAND NEW MITSUBISHI CARS & TRUC

NOW IN STOCK FOR IMMEDIATE DELIVERY!

NEW 1983 PICK-UPS*

NEW 19 CORDI

THIS AGREEMENT, made the 7 day of MAY 19 82 by and between [illegible] MOTORS CORP of ROUTE 22 NORTH PLAINFIELD NJ 07060
(Creditor - Seller's Name) (Address of Seller's place of business)
hereinafter called "Seller", and [illegible]
(Customer - Buyer's Name)
of 611 HIGH ST APT 4H NEWARK NJ 07102
(Residence of individual Buyer or place of business if commercial Buyer) (Zip Code)

EXHIBIT B

Seller hereby sells and Buyer hereby purchases, subject to the terms hereof, including EXHIBIT "A" printed on the other side, the following Motor Vehicle [illegible]

	Make	No. of Cylinders	Body Type (If Truck, Give Tonnage)	Color	Model	New or Used	Year	Serial Number	Key Number
One	CHEV	6	4DR	WHITE	MALIBU	USED	1976	1W19H0D477899	

And Special Equipment Checked: Radio (AM ☐ FM ☐ Stereo ☐) Automatic Transmission ☐ Air Cond. ☐ Vinyl Roof ☐ Power Steering ☐ Power Brakes ☐ Power Windows ☐ Other: ____ (Specify)

NOTICE: Any holder of this Consumer Credit Contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof. Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder.

For the price calculated as follows:

(1) Cash Price (including Sales Tax of $ 231.85) $ 4868.85

(2) Down Payment N.D.
- (a) Trade-In ____ $ ____ Make ____ Model ____ Serial # ____ Year ____
- (b) Less: Amount Owing $ N.D.
- (c) Net Allowance $ N.D.
- (d) Cash Down Payment $ 1050.00
- (e) Total Down Payment (Items (c) and (d)) $ 1050.00

(3) Unpaid Balance of Cash Price (Item (1) minus Item (2)(e)) $ 3818.85

(4) Insurance Premiums and Other Charges (No Insurance Coverage Unless Premium Shown & Box Checked)
- (a) Credit Insurance for Term of Contract:
  - Credit Life $ 125.73
  - Credit Accident & Health $ 210.70
- (b) Cost of Property Insurance if Optioned Thru Creditor (Term: ____ Months) $ N.D.
  - Comprehensive or Fire and Theft ☐
  - $ ____ Deductible Collision ☐
  - Combined Additional Coverage ☐
  - Towing and Labor ☐
  - Personal Effects ☐

(BUYER MAY CHOOSE PERSON THROUGH WHICH ABOVE INSURANCE IS TO BE OBTAINED. IF BUYER SO CHOOSES, NAME OF PERSON IS: ____)

This does not include insurance on your liability for bodily injury or property damage. Without such insurance, you may not operate this vehicle on public highways.

- (c) Other Charges (Itemize).
  - $ N.D.
  - P.V. FEES $ 28.50
  - [illegible] $ 329.00

(5) Unpaid Balance - Amount Financed (Item (3) + Item (4)) $ 4522.78

(6) FINANCE CHARGE $ 2385.26

ANNUAL PERCENTAGE RATE 22.95 %

(7) Total of Payments (Item (5) + Item (6)) $ 6908.04

(8) Deferred Payment Price (Items (1) + (4) + (6)) $ 7958.04

Which Total of Payments (Item(7)) Buyer promises to pay to Seller or Successor in 36 equal monthly installments of $ 191.89 each (and a final unequal installment of $ ____), the first to be paid on JULY 06 1982 (one month from the date hereof unless otherwise stated) and one installment on the same date of each following month until paid at the office of

UNITED NATIONAL BANK
Plainfield, New Jersey

It is anticipated that this contract, when fully completed and signed and the Vehicle delivered, will be submitted to the above Bank and, if approved, that it will be assigned to the Bank. United National Bank may be deemed a Creditor under Truth in Lending laws and regulations.

[illegible] MOTORS CORP (L.S.)
(Seller)
(Owner, Officer or Firm member)

THE PURCHASE OF CREDIT LIFE, ACCIDENT AND HEALTH COVERAGE IS NOT REQUIRED FOR CREDIT. I WANT THE COVERAGE(S) CHECKED FOR THE PREMIUM(S) SHOWN IN ITEM 4(a). 05/07/82
Signature of Buyer Date
Creditor Insurance Covers Only Buyer Signing Above

1. Seller retains a purchase money Security Interest in the Vehicle and accessions thereto and any insurance refunds and insurance proceeds resulting from loss or damage to the Vehicle until Buyer fully performs hereunder.

2. If before the date scheduled for the payment of the final installment, the unpaid balance owing on this contract is paid in full or the maturity of the unpaid balance is accelerated then Buyer shall be entitled to a credit for the unearned portion of the Finance Charge calculated according to the actuarial refund method as if all payments were made as scheduled or if deferred, as deferred; provided, however, that if the contract is prepaid within 12 months after the first payment is due, Buyer may be charged a prepayment penalty of not more than (a) $20 if the original Amount Financed is $2,000 or less, or (b) 1% of the original Amount Financed if the Amount Financed is more than $2,000 but not more than $5,000 or (c) $100 if the original Amount Financed is more than $5,000.

3. If Buyer defaults in an installment payment for not less than 10 days, a late charge in the amount of 5% of such payment or $5.00, whichever is less, shall be charged. Upon default by Buyer the entire unpaid balance of the Total of Payments shall, at the option of the Holder, become immediately due and payable. Upon acceleration Buyer shall be given the same credit for unearned Finance Charge as upon prepayment.

WILL VEHICLE BE USED PRIMARILY FOR COMMERCIAL OR BUSINESS PURPOSES? ☐ YES ☐ NO

Buyer agrees that Vehicle shall be located at his address above given unless otherwise stated:

____
(Address if other than above)

This writing, including Exhibit "A" on back hereof, constitutes the entire agreement between the parties hereto. Unless Seller gives Buyer a separate written warranty, Seller hereby expressly disclaims all warranties, either express or implied, including any implied warranty of merchantability or fitness for a particular purpose.

(If More than One Buyer, Obligation of each is several)

Notice to Retail Buyer

Do not sign this contract in blank.

You are entitled to a copy of the contract at the time you sign. Keep it to protect your legal rights.

UNDERSIGNED ACKNOWLEDGES RECEIPT BEFORE SIGNING OF AN EXACT COPY OF ABOVE, COMPLETELY FILLED IN.

(1) ____ 05/07/82 (L.S.)
(Buyer Sign Here)
(2) ____ (L.S.)
(Co-Obligor)

NOTICE OF PROPOSED GROUP CREDIT INSURANCE

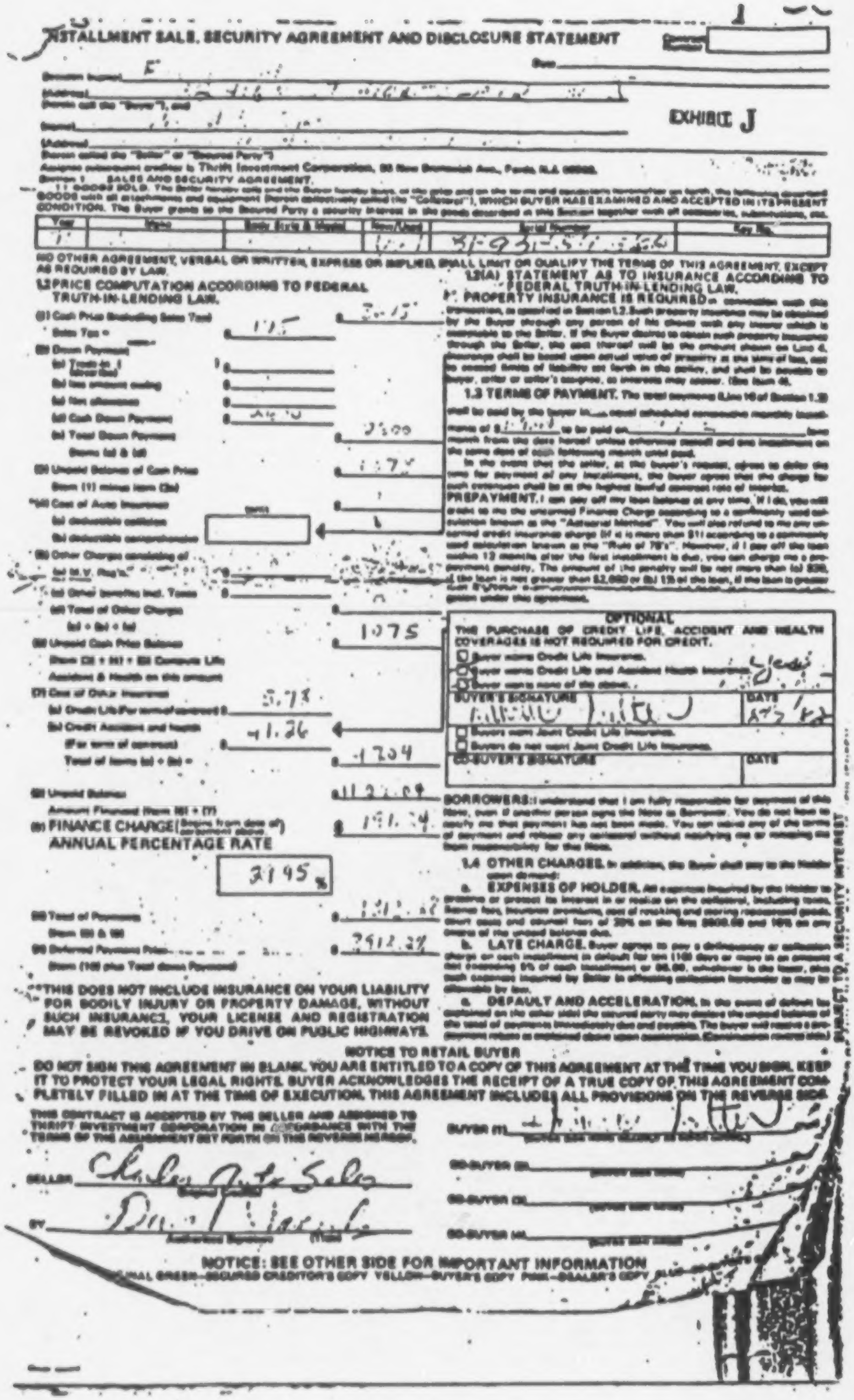
[illegible]

[illegible]

[illegible]

6-2463

The above Notice of Proposed Group Credit Insurance only applies if the coverage is to be submitted to Old Republic Life Insurance Company.



INSTALLMENT SALE, SECURITY AGREEMENT AND DISCLOSURE STATEMENT

Contract Number

EXHIBIT J

Date ______

Between buyer(s) E[illegible]

(Address) [illegible]

(herein call the "Buyer"), and

(name) [illegible]

(Address) [illegible]

(herein called the "Seller" or "Secured Party")

Assignee subsequent creditor is Thrift Investment Corporation, [illegible] New Brunswick Ave., Fords, N.J. [illegible]

Section 1 SALES AND SECURITY AGREEMENT.

1.1 GOODS SOLD. The Seller hereby sells and the Buyer hereby buys, at the price and on the terms and conditions hereinafter set forth, the following described GOODS with all attachments and equipment (herein collectively called the "Collateral"), WHICH BUYER HAS EXAMINED AND ACCEPTED IN ITS PRESENT CONDITION. The Buyer grants to the Secured Party a security interest in the goods described in this Section together with all accessories, substitutions, etc.

Year	Make	Body Style & Model	New/Used	Serial Number	Key No.
7[illegible]			[illegible]	31-931-5[illegible]	

NO OTHER AGREEMENT, VERBAL OR WRITTEN, EXPRESS OR IMPLIED, SHALL LIMIT OR QUALIFY THE TERMS OF THIS AGREEMENT, EXCEPT AS REQUIRED BY LAW.

1.2 PRICE COMPUTATION ACCORDING TO FEDERAL TRUTH-IN-LENDING LAW.

(1) Cash Price (including Sales Tax)		$ 3[illegible]75
Sales Tax =	$ 175	
(2) Down Payment		
(a) Trade-in [illegible]	$	
(b) less amount owing	$	
(c) Net allowance	$	
(d) Cash Down Payment	$ 2000	
(e) Total Down Payment Items (c) & (d)		$ 2000
(3) Unpaid Balance of Cash Price Item (1) minus item (2e)		$ 1075
**(4) Cost of Auto Insurance		$
(a) deductible collision		
(b) deductible comprehensive		
(5) Other Charges consisting of		
(a) M.V. Reg'n.	$	
(b) Other benefits incl. Taxes	$	
(c) Total of Other Charges (a) + (b) + (c)		$
(6) Unpaid Cash Price Balance Item (3) + (4) + (5) Compute Life Accident & Health on this amount		$ 1075
(7) Cost of Other Insurance		
(a) Credit Life (For term of contract)	$ 5.78	
(b) Credit Accident and health (For term of contract)	$ 41.26	
Total of items (a) + (b) =		$ 47.04
(8) Unpaid Balance: Amount Financed (item (6) + (7))		$ 1122.04
(9) FINANCE CHARGE (Begins from date of agreement above)		$ 191.24
ANNUAL PERCENTAGE RATE	31.95 %	
(10) Total of Payments Item (8) & (9)		$ 1312.28
(11) Deferred Payment Price Item (10) plus Total down Payment		$ 3312.28

Box for auto insurance: Term [illegible]

**THIS DOES NOT INCLUDE INSURANCE ON YOUR LIABILITY FOR BODILY INJURY OR PROPERTY DAMAGE, WITHOUT SUCH INSURANCE, YOUR LICENSE AND REGISTRATION MAY BE REVOKED IF YOU DRIVE ON PUBLIC HIGHWAYS.

1.2(A) STATEMENT AS TO INSURANCE ACCORDING TO FEDERAL TRUTH-IN-LENDING LAW.

PROPERTY INSURANCE IS REQUIRED in connection with this transaction, as specified in Section 1.2. Such property insurance may be obtained by the Buyer through any person of his choice with any insurer which is acceptable to the Seller. If the Buyer desires to obtain such property insurance through the Seller, the cost thereof will be the amount shown on Line 4. Coverage shall be based upon actual value of property at the time of loss, not to exceed limits of liability set forth in the policy, and shall be payable to buyer, seller or seller's assignee, as interests may appear. (See Item 4).

1.3 TERMS OF PAYMENT. The total payments (Line 10 of Section 1.2) shall be paid by the buyer in ___ equal scheduled consecutive monthly installments of $[illegible] to be paid on [illegible] from month from the date hereof unless otherwise stated and one installment on the same date of each following month until paid.

In the event that the seller, at the buyer's request, agrees to defer the time for payment of any installment, the buyer agrees that the charge for such extension shall be at the highest lawful contract rate of interest.

PREPAYMENT. I can pay off my loan balance at any time. If I do, you will credit to me the unearned Finance Charge according to a commonly used calculation known as the "Actuarial Method". You will also refund to me any unearned credit insurance charge (if it is more than $1) according to a commonly used calculation known as the "Rule of 78's". However, if I pay off the loan within 12 months after the first installment is due, you can charge me a prepayment penalty. The amount of the penalty will be not more than (a) $20, if the loan is not greater than $2,000 or (b) 1% of the loan, if the loan is greater than $2,000 [illegible] under this agreement.

OPTIONAL

THE PURCHASE OF CREDIT LIFE, ACCIDENT AND HEALTH COVERAGES IS NOT REQUIRED FOR CREDIT.

☐ Buyer wants Credit Life Insurance.
☐ Buyer wants Credit Life and Accident Health Insurance. Yes
☐ Buyer wants none of the above.

BUYER'S SIGNATURE	DATE
[illegible]	[illegible] '82

☐ Buyers want Joint Credit Life Insurance.
☐ Buyers do not want Joint Credit Life Insurance.

CO-BUYER'S SIGNATURE	DATE

BORROWERS: I understand that I am fully responsible for payment of this Note, even if another person signs the Note as Borrower. You do not have to notify me that payment has not been made. You can waive any of the terms of payment and release any collateral without notifying me or releasing me from responsibility for this Note.

1.4 OTHER CHARGES. In addition, the Buyer shall pay to the Holder upon demand:

a. **EXPENSES OF HOLDER.** All expenses incurred by the Holder to preserve or protect its interest in or realize on the collateral, including taxes, license fees, insurance premiums, cost of retaking and storing repossessed goods, court costs and counsel fees of 20% on the first $500.00 and 10% on any excess of the unpaid balance due.

b. **LATE CHARGE.** Buyer agrees to pay a delinquency or collection charge on each installment in default for ten (10) days or more in an amount not exceeding 5% of each installment or $5.00, whichever is the lesser, plus such expenses incurred by Seller in effecting collection hereunder as may be allowable by law.

c. **DEFAULT AND ACCELERATION.** In the event of default (as explained on the other side) the secured party may declare the unpaid balance of the total of payments immediately due and payable. The buyer will receive a prepayment rebate as explained above upon acceleration. (Continuation reverse side)

SUBJECT TO A SECURITY INTEREST

NOTICE TO RETAIL BUYER

DO NOT SIGN THIS AGREEMENT IN BLANK. YOU ARE ENTITLED TO A COPY OF THIS AGREEMENT AT THE TIME YOU SIGN. KEEP IT TO PROTECT YOUR LEGAL RIGHTS. BUYER ACKNOWLEDGES THE RECEIPT OF A TRUE COPY OF THIS AGREEMENT COMPLETELY FILLED IN AT THE TIME OF EXECUTION. THIS AGREEMENT INCLUDES ALL PROVISIONS ON THE REVERSE SIDE.

THIS CONTRACT IS ACCEPTED BY THE SELLER AND ASSIGNED TO THRIFT INVESTMENT CORPORATION IN ACCORDANCE WITH THE TERMS OF THE ASSIGNMENT SET FORTH ON THE REVERSE HEREOF.

SELLER Charles Auto Sales
(Seller's Name)

BY [illegible]
Authorized Signature (Title)

BUYER (1) [illegible]
(BUYER SIGN HERE)

CO-BUYER (2) ______
(BUYER SIGN HERE)

CO-BUYER (3) ______
(BUYER SIGN HERE)

CO-BUYER (4) ______
(BUYER SIGN HERE)

NOTICE: SEE OTHER SIDE FOR IMPORTANT INFORMATION

ORIGINAL GREEN—SECURED CREDITOR'S COPY YELLOW—BUYER'S COPY PINK—DEALER'S COPY

[illegible]

Date 3/1 1982

Customer: LUIS A. MALQUET
(PRINT FULL NAME)

Address: 917 Peterson St Perth Amboy NJ
(NO., STREET) (CITY) (STATE) (ZIP)

Seller: Gerardi Toyota
(NAME)

Address: 119 Rt 18 Hoboken N-J
(NO., STREET) (CITY) (ZIP)

EXHIBIT K

Customer (which means the undersigned Purchaser and Co-Purchaser (jointly and severally) having been offered both [illegible]) hereby purchases from Seller on a time price basis, upon the terms and conditions set forth on the face and reverse side [illegible] of which in good order are hereby acknowledged by Customer.

New Or Used	Year and Make	No. of Cylinders	Body Type (If Truck, Give Tonnage)	Color	Model	Serial Number	Key Number	Will For Below Put (Used)
Used	1975 Toyota	4	2 door	Red	Celica	RA00010052		☐ Personal ☐ Farm ☐ Business

Equipped with: ☐ Radio ☐ Automatic Trans. ☐ Air Conditioner ☐ Other ____
Power: ☐ Steering ☐ Brakes ☐ Windows ☐ Seats ____

To be Garaged or Located at:
☐ Customer's Address Above, or
☐ [illegible] ____

DESCRIPTION OF TRADE IN

1970 Buick $ 1400.00
(YEAR AND MAKE) (GROSS ALLOWANCE)

____ $ 0.00
(SERIAL NUMBER) (AMOUNT OWING)

INSURANCE AVAILABLE

Automobile Physical Damage Insurance. Customer May Choose The Person Through Which This Insurance Is To Be Obtained. If authorized, Seller will obtain coverages checked below for a term of ____ months from date hereof, [illegible], payable to Customer, Seller or Seller's Assignee, as interests may appear:

☐ Comprehensive
☐ Fire-Theft & Combined Additional Coverage
☐ $____ Deductible Collision
☐ Towing & Labor Costs
☐ Other (describe) ____

$ NONE

THIS DOES NOT INCLUDE INSURANCE ON YOUR LIABILITY FOR BODILY INJURY OR PROPERTY DAMAGE. WITHOUT SUCH INSURANCE, YOU MAY NOT OPERATE THIS VEHICLE ON PUBLIC HIGHWAYS.

CREDIT INSURANCE ELECTION

CREDIT LIFE and/or CREDIT ACCIDENT and HEALTH INSURANCE ARE Not required to obtain this loan.

☐ No Credit Life Insurance is provided.
☐ No Credit Accident and Health Insurance is provided.

____ Date ____ Signature-Borrower

Credit Life Insurance and/or Credit Accident and Health Insurance is provided if customer to be insured signs below approving the cost of such insurance for the term of the credit.

☐ Credit Life Insurance provided by JLJC $ 18.18

In accordance with the separate Application, Notice, Certificate or Policy delivered to Customer this date.

☐ Credit Accident and Health Insurance provided by JLJC $ 73.85

In accordance with the separate Application, Notice, Certificate or Policy delivered to Customer this date.

Total cost of Insurance $ 92.03

Acknowledging the foregoing, Borrower requests insurance coverage [illegible]

3/1/82 Luis A. Malquet
Date Signature of Borrower to be Insured

(Cost of Insurance to be included only if Borrower signed)

WILL VEHICLE BE USED PRIMARILY FOR COMMERCIAL OR BUSINESS PURPOSES?
☐ Yes ☐ No

If yes, the following paragraph applies:
Customer acknowledges notice that this contract may be assigned. To induce an assignee to purchase this contract from Seller, Customer agrees not to assert against such assignee any claim Customer may have against such Seller provided:
1. Assignee mails Customer written notice of such assignment, and
2. Customer fails to notify assignee of any breach by Seller within [illegible] days after such mailing.

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

The above named dealer as an arranger of credit has arranged with Heritage Bank — North at 966 Cranbury Road, East Brunswick, New Jersey 08816, to become the assignee of this contract. The said bank may be considered a creditor under applicable law.

The foregoing contract hereby is accepted by Seller and assigned under the terms of the assignment below.

Seller: Gerardi Toyota Signature of Dealer (Seller)
By: ____ Title ____

1. Cash Price (including sales tax of $ 100.00)		$ 3500.00 (1)
Cash Downpayment	$ 347.00	
Trade in (see [illegible])	$ 1400.00	
2. Total Downpayment		$ 1747.00 (2)
3. Unpaid Balance of Cash Price		$ 1753.00 (3)
4. Other Charges		
A. Cost of Insurance, if any, which Customer authorizes Seller to obtain (See [illegible])	$ 92.03	
B. Official fees (specify)	$ NONE	
C. Other (specify) EXT. WARR.	$ 420.00	
Total Other Charges		$ 512.03 (4)
5. Unpaid Balance - Amount Financed		$ 2265.03 (5)
6. **FINANCE CHARGE**		$ 575.19 (6)
7. Total of Payments (Sum of Items 5&6)		$ 2840.22 (7)
8. Deferred Payment Price (Sum of Items 1, 4&6)		$ 4587.22 (8)
9. **ANNUAL PERCENTAGE RATE**		24.99 % (9)

10. Payment Schedule: Customer hereby agrees to pay Seller the Total of Payments (Item 7 above) in 18 monthly installments of $ 157.79 each, all payable the like date of each succeeding month commencing March 31, 1982 at the office of Heritage Bank North, 966 Cranbury Road, East Brunswick, N. J. 08816.

11. Delinquency and Collection Charges. Customer agrees to pay (a) a delinquency charge on each installment in default for more than 10 days in the amount of 5% thereof or $5.00, whichever is less, and (b) a attorney's fees of 20% on the first $500 and 10% on any excess of the amount due under this contract when referred to an attorney, not a salaried employee of the holder, for collection.

12. Security Interest: To secure payment of the Total of Payments shown above and all other amounts due or to become due hereunder, Customer hereby grants to Seller (and its assigns) a security interest in the above described goods, together with all equipment, accessories and additions thereto, all replacements and substitutions therefor and any monies (including return of unearned premiums) which do or may become payable to customer on account of insurance on the goods or other insurance (including Credit Life and Accident and Health Insurance) obtained in connection with this transaction.

13. Prepayment or Acceleration: Customer may repay the balance owing on this contract in full at any time before the end of the contract period. When the unpaid balance is prepaid in full or the maturity of the unpaid balance is accelerated, a credit will be given for unearned finance charges as computed by the Rule of 78's, after first deducting an acquisition charge of $15.00. If the amount of such credit is less than $1.00, it will not be given.

14. Additional Terms and Conditions: The additional terms and conditions set forth on the reverse side hereof are a part of this contract and are incorporated herein by reference.

NOTICE TO RETAIL BUYER:

Do not sign this contract in blank.
You are entitled to a copy of the contract at the time you sign.
Keep it to protect your legal rights.
Customer acknowledges receipt of a true and completely filled in copy of this contract at the time of signing.

Sign ☞ Luis A Malquet (Customer)
Sign ☞ ____ Co-Purchaser (Customer)
Sign ☞ ____ Co-Purchaser (Customer)
Sign ☞ ____ Co-Purchaser (Customer)

NOTICE OF PROPOSED GROUP CREDIT INSURANCE

Premiums for Group Credit Life and/or Accident and Health Insurance are included in this transaction, subject to acceptance by the insurer, The Central National Life Insurance Company of Omaha, only if the proper block above is checked. Such insurance will cover only the individual designated and signing this instrument as the person to be insured. The amount of life insurance is the amount necessary at any time to discharge the indebtedness or $20,000.00 whichever is less. The term of such insurance, upon acceptance by the insurer, will commence as of the date the indebtedness is incurred and will be the same as the term of the indebtedness. The proceeds of such insurance will be applicable to reduction or discharge of the indebtedness. If such insurance is declined by the insurer or otherwise does not become effective the amount of the charge therefor and the credit service charge thereon will be credited to customer's account. The foregoing is subject to the provisions of the certificate or statement of insurance which will be issued to the person insured. Any refund will be calculated in accordance with the "Rule of 78" formula; however, that no such refund shall be made if the amount thereof is less than $1.00

3/1/82 The above Notice of Proposed Group Credit Insurance only applies if the coverage is to be submitted to The Central National Life Insurance Company of Omaha.

S. 730 WOULD PROHIBIT STATE REGULATION

Senator PROXMIRE. Then on page 2, the first full paragraph of your statement, you say S. 730 would prohibit state regulation of almost every aspect of the consumer financial transactions. No matter how predatory, no matter how unfair, no matter how widespread the lending practice may be, any loan for any rate of interest on any terms would be legal.

Mr. NISHIMURA. Senator, what I was attempting to say at that point is that should you run across—for instance, in Washington, D.C., when reporter Ellen Kingsley ran across a certain kind of scam that was going on on second mortgage loans—should you run across that kind of thing in any State and the State would want to move to prevent that type of thing happening because the State thought it was predatory, I believe that S. 730 would prohibit the State from doing so.

Senator PROXMIRE. Except the State can override?

Mr. NISHIMURA. Yes, Senator, I was about to respond to Senator Garn's statement. We don't believe that that is realistic.

Senator PROXMIRE. Why not?

Mr. NISHIMURA. I worked in Arkansas for 8 years as a consumer advocate, and I think that that provision turns the tables on consumers trying to protect their rights in the State. It is vastly different from us being in a position where we have to protect existing circumstances.

Senator PROXMIRE. In Arkansas you have two of the most sensitive Senators in this body, Pryor and Bumpers. They were after this committee, pleading with us on bended knee, believe me, to do something about that Arkansas provision in the constitution that had a usury ceiling that they just said made business impossible.

They said banks couldn't do business, that the people who were in the automobile business couldn't do business. People had to go out of State in order to buy cars. They couldn't borrow money at the 10-percent limit.

Mr. NISHIMURA. Senator, there are a lot of responses to each of your points there because Arkansas used car dealers and new car dealers were advertising to people to come over the line and buy in Arkansas, because, they were saying "look, if you pay 10 percent, your actual car will cost $1,700 less than if you buy in Memphis."

But as to your initial point ——

Senator PROXMIRE. Let me just say that both Senators Pryor and Bumpers are very sensitive to their State. They are very close to the consumers. I am sure their whole record indicates that, and I would be shocked and surprised if they weren't reflecting the realistic views of people who wanted the economy to prosper, not at anybody's expense.

ARKANSAS CHANGES LAW TO LIKING OF VOTERS

Mr. NISHIMURA. Senator, the fact that Arkansas has changed its laws to the liking of the voters in 1982 is proof that the process works.

The reason the law was not changed earlier—as I mentioned in my written statement—was because lenders were asking for too much. They were not only asking for higher rates; they were asking for a wide variety of rates that Louisiana, for example, imposes. They were asking for a weakening of the definition of interest rates. They were asking for a reduction of penalties to make it almost impossible for anyone who was charging a usurious rate to take them to court.

We said that to them in 1974. The lenders didn't go to labor. They didn't come to consumer groups. They said this is what we are going to do because the economy needs it.

We said that is never going to fly, and it didn't. It got tromped 7 to 1. They tried it again in 1980 because they felt they had another vehicle. They felt they did not have to confer with affected groups or respond to those types of needs that the consumers had expressed.

They felt they had a vehicle in a proposed constitutional rewrite in Arkansas, that would force the issue through.

It is a long story, but what happened, we believed, was that the issue dragged the constitution down in 1980.

Finally, in 1982, lenders came to the position of asking, "All right, what do you want?" We submitted a page, saying, do not touch the penalties. Do not change the definition of interest. We are willing to accept higher rates in this range.

That was what the legislature passed. It was put on the ballot and passed in 1982. The process worked because it was a negotiation.

Senator PROXMIRE. We should try to apply that lesson, if members of the committee want to think about this. If this legislation were to prohibit unconscionable rates, as you put it, what should the limit be?

Mr. NISHIMURA. Senator, you know, it would be a shot in the dark.

Senator PROXMIRE. We often shoot in the dark. [Laughter.]

Mr. NISHIMURA. I don't know what the limit should be, Senator. I leave it up to your judgment on that.

I don't approve of Federal preemption that would go across all State lines.

USURY CEILINGS, WERE NOT THE PROBLEM

Senator PROXMIRE. Mr. Schechter, you cite the fact that as mortgage interest rates declined after the passage of the Depository Institutions Deregulation Act of 1980, that is an argument that usury ceilings were not really the problem.

Doesn't the decline also suggest that there is adequate competition in the marketplace to prevent interest rates from skyrocketing if we remove all usury ceilings?

Mr. SCHECHTER. The adequate competition came along after the economy became quite weak, when we had about 10 million people unemployed and when our manufacturing capacity utilization was going down to where it reached the point of 67 percent—and we are just up to 68½ percent now.

Of course, there was nobody who wanted to borrow much money for business. So, we began to get more money. And I say if that is the process we think we have to live with, we have lost our economic creativeness in this country.

Senator **Proxmire**. But that is always the case, isn't it? You are a very competent economist. You know perfectly well that in periods of unemployment, and so forth, interest rates fall; in periods of vigorous activity and recovery they tend to rise.

Mr. **Schechter**. Sure, but how much time?

Senator **Proxmire**. But overwhelming everything else?

Mr. **Schechter**. The question is how much time do we have to spend in these adjustment periods with the process we have?

We still have the same process we have had for the last 40 years, and the economy has changed. It has changed the whole nature of capital flows and of savings and investment decisions.

We are still trying to live with something—after all, the Federal Reserve was created 70 years ago. We ought to make some modification to fit present circumstances.

Senator **Proxmire**. Ms. Broadman, in your testimony you talk about abuses in States where usury limits have been removed.

Could you give us some examples of the abuses?

Ms. **Broadman**. In Arizona, when usury ceilings were lifted there, legal services lawyers reported contracts with interest rates of 50 percent and more.

The types of business we are talking about typically involve consumers who have language problems, consumers who are unsophisticated, low income, uneducated, who don't understand the contracts that they are signing.

Senator **Proxmire**. Well, that is a serious charge.

For the record, could you give us as many examples as possible?

Ms. **Broadman**. I would be happy to do that.

[Information follows:]

Consumers Union
Publisher of Consumer Reports

May 5, 1983

Beth Climo
Senate Banking Committee
SD-534
Washington, D.C. 20510

Dear Beth:

Enclosed are some materials describing the high interest rates charged on loans in Arizona as well as in other states that have raised or eliminated their usury ceilings. Please include them in the record for the hearings on federal preemption of state usury ceilings.

Sincerely,

Ellen Broadman
rmj

Ellen Broadman
Counsel for Government
Affairs

EB:rmj

Enclosures

Washington Office
3rd Floor, 1146 Nineteenth Street, Northwest · Washington, D.C. 20036 · (202) 833-2580

Southern Arizona Legal Aid, Inc.
155 East Alameda
Tucson, Arizona 85701
602-623-9461

Executive Director
John G. Balentine

United Way

April 10, 1981

Clarence John
Texas Legal Services Center
500 W. 13th Street
Austin, Texas 78701

Re: Usury Limits

Dear Clarence:

As I explained in our phone conversation on April 9, 1981, since Arizona abolished usury restrictions on April 23, 1980, many problems have occurred. The most dramatic early indication of problems is in the used car market. In this market there is essentially 50% higher than the previous limit of 12% add-on interest (approximately 21% APR) to the present prevailing market rate of 18% add-on (approximately 31% APR).

To indicate some of the problems that have arisen I have included copies of 2 contracts and some newspaper advertisements. The one contract for Ames Brothers, Inc. is particularly hard to read, but the APR on that contract is 50.91%. Yes fifty not thirty. In fact, if you assume regular payments instead of a 45 day first period, the APR calculation is closer to 53%.

The other contract from Century Motors is also, unfortunately, difficult to read, but it has an APR of 32.46%. This contract is dated 29 days after the new law went into effect.

I have put a capital letter on the xeroxed advertisements to identify them. I will briefly explain the significance of these ads as I seem them.

A. Since last summer O'Reilly Speedway has consistently advertised at 18% add-on or between 31% and 32% APR depending on the length of the loan. You can see the APR in the small printed examples below the lists of vehicles.

B. The Mirale Mile Motors advertisements also reflects in small print APR's of approximately 31.5% Miracle Mile Motors has expanded dramatically since the usury law was abolished.

C. The "Income Tax Refund Sale" is for Blue Chip Motors. It gives you an idea of how many cars Blue Chip has to sell. Towards the middle of the top is the City of Cars ad. It indicates an APR of 30.00%. The ad also indicates their lack of concern with your credit worthiness ("no credit checks").

D. Again there is the City of Cars ad for 29.9%. One of the arguments for high interest rates is the high risk of the loan. However, these loans have at least a 30.00% down payment and the financing extends only for 12 months. Plus, the creditor has a security interest in that cherry used car just sold. If the creditor argues that the security is valueless then maybe the initial sale was fraudulent (i.e. selling a "lemon"). The bottom line is that the high risk argument does not cut it. The dealer has all of his investment back by the second payment.

Also, notice the large ads for buying cars. The used car dealers are anxious to get their hands on cars because they can make so much money on the financing.

E. Following upon on how hungry used car dealers are to get cars is my personal favorite, the O'Reilly free dinner offer. Note in the examples APR's of 31.46. The plain fact is that financing used cars at 31.5% is very lucrative. Give me more cars is the current cry.

F,G, & H - Along the same theme, you can say how many cars Bluse Chip Motors and City of Cars has to advertise. In H, you can see that they have the largest advertisements for buying used cars. Also, notice that credit worthiness is absolutely no consideration for these two companies. They make so much money on the down payment, exorbitant interest charges and subsequent repossession resale, that these companies need not be worried about the buyer's ability to perform the contract. This is a tremendous danger, where a creditor no longer looks to performance of the contract terms in entering a contract. The result is usually unfortunate for the buyer.

The biggest problems we have seen since the law abolishing usury limits is in home equity lending and used car lending. It is clear to me in reviewing many contracts, interviewing hundreds of clients and reviewing newspaper ads, that disclosure laws and the competition of a free market place do not protect consumers. The removal or restructuring of consumer protections like usury limitations is in my opinion ill-advised and a great disservice to the constituency your legislator's serve.

If you have any questions, feel free to give me a call.

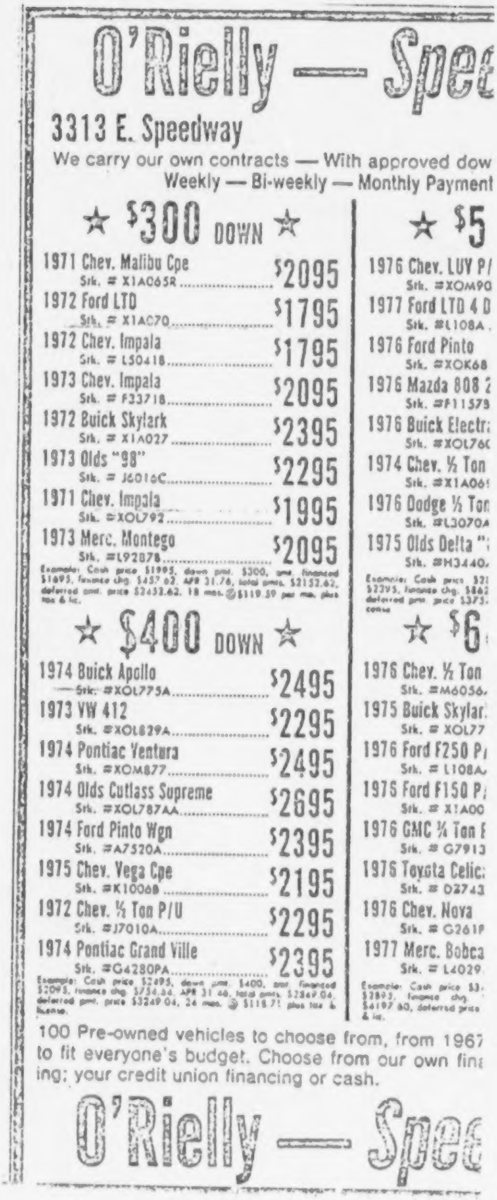
Sincerely,

SOUTHERN ARIZONA LEGAL AID, INC.

Charles R. Pyle

Charles R. Pyle
Attorney at Law

CRP:mcc
cc: Rep. Clare Dunn
Robert Hobbs



O'Rielly — Spee

3313 E. Speedway

We carry our own contracts — With approved dow
Weekly — Bi-weekly — Monthly Payment

★ $300 DOWN ★

1971 Chev. Malibu Cpe Stk. # X1A065R	$2095
1972 Ford LTD Stk. # X1AC70	$1795
1972 Chev. Impala Stk. # L50418	$1795
1973 Chev. Impala Stk. # F33718	$2095
1972 Buick Skylark Stk. # X1A027	$2395
1973 Olds "98" Stk. # J6016C	$2295
1971 Chev. Impala Stk. #XOL792	$1995
1973 Merc. Montego Stk. #L92878	$2095

Example: Cash price $1995, down pmt. $300, amt. financed $1695, finance chg. $457.62, APR 31.76, total pmts. $2152.62, deferred pmt. price $2452.62. 18 mos. @ $119.59 per mo. plus tax & lic.

★ $400 DOWN ★

1974 Buick Apollo Stk. #XOL775A	$2495
1973 VW 412 Stk. #XOL829A	$2295
1974 Pontiac Ventura Stk. #XOM877	$2495
1974 Olds Cutlass Supreme Stk. #XOL787AA	$2695
1974 Ford Pinto Wgn Stk. #A7520A	$2395
1975 Chev. Vega Cpe Stk. #K1006B	$2195
1972 Chev. ½ Ton P/U Stk. #J7010A	$2295
1974 Pontiac Grand Ville Stk. #G4280PA	$2395

Example: Cash price $2495, down pmt. $400, amt. financed $2095, finance chg. $754.04, APR 31.46, total pmts. $2849.04, deferred pmt. price $3249.04, 24 mos. @ $118.71 plus tax & license.

★ $5

1976 Chev. LUV P/
Stk. #XOM90
1977 Ford LTD 4 D
Stk. #L108A
1976 Ford Pinto
Stk. #XOK68
1976 Mazda 808 2
Stk. #F11578
1976 Buick Electr
Stk. #XOL76C
1974 Chev. ½ Ton
Stk. #X1A06
1976 Dodge ½ Ton
Stk. #L3070A
1975 Olds Delta "
Stk. #H3440

Example: Cash price $2
$2395, finance chg. $86
deferred pmt. price $375
cense

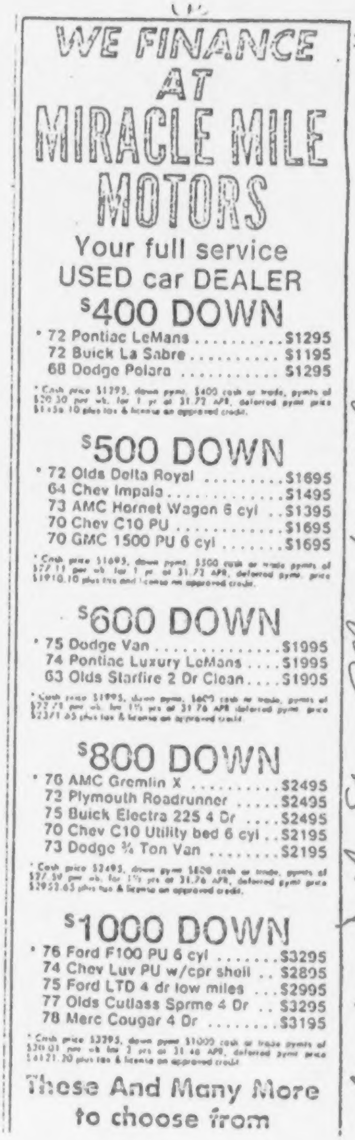
★ $6

1976 Chev. ½ Ton
Stk. #M6056
1975 Buick Skylar
Stk. # XOL77
1976 Ford F250 P
Stk. # L108A
1975 Ford F150 P
Stk. # X1A00
1976 GMC ¾ Ton
Stk. # G7913
1976 Toyota Celic
Stk. # D2743
1976 Chev. Nova
Stk. # G261P
1977 Merc. Bobca
Stk. # L4029

Example: Cash price $3
$2895, finance chg.
$4197.80, deferred price
& lic.

100 Pre-owned vehicles to choose from, from 1967 to fit everyone's budget. Choose from our own fin ing; your credit union financing or cash.

O'Rielly — Spee



WE FINANCE
AT
MIRACLE MILE
MOTORS

Your full service
USED car DEALER

$400 DOWN

* 72 Pontiac LeMans	$1295
72 Buick La Sabre	$1195
68 Dodge Polara	$1295

* Cash price $1295, down pymt. $400 cash or trade, pymts of $20.30 per wk. for 1 yr at 31.72 APR, deferred pymt price $1456.10 plus tax & license on approved credit.

$500 DOWN

* 72 Olds Delta Royal	$1695
64 Chev Impala	$1495
73 AMC Hornet Wagon 6 cyl	$1395
70 Chev C10 PU	$1695
70 GMC 1500 PU 6 cyl	$1695

* Cash price $1695, down pymt. $500 cash or trade pymts of $27.11 per wk. for 1 yr at 31.72 APR, deferred pymt. price $1910.10 plus tax and license on approved credit.

$600 DOWN

* 75 Dodge Van	$1995
74 Pontiac Luxury LeMans	$1995
63 Olds Starfire 2 Dr Clean	$1995

* Cash price $1995, down pymt. $600 cash or trade, pymts of $22.71 per wk. for 1½ yrs at 31.76 APR deferred pymt price $2371.65 plus tax & license on approved credit.

$800 DOWN

* 76 AMC Gremlin X	$2495
72 Plymouth Roadrunner	$2495
75 Buick Electra 225 4 Dr	$2495
70 Chev C10 Utility bed 6 cyl	$2195
73 Dodge ¾ Ton Van	$2195

* Cash price $2495, down pymt $800 cash or trade, pymts of $27.59 per wk. for 1½ yrs at 31.76 APR, deferred pymt price $2952.65 plus tax & license on approved credit.

$1000 DOWN

* 76 Ford F100 PU 6 cyl	$3295
74 Chev Luv PU w/cpr shell	$2895
75 Ford LTD 4 dr low miles	$2995
77 Olds Cutlass Sprme 4 Dr	$3295
78 Merc Cougar 4 Dr	$3195

* Cash price $3295, down pymt $1000 cash or trade pymts of $30.01 per wk for 2 yrs at 31.46 APR, deferred pymt price $4121.20 plus tax & license on approved credit.

These And Many More
to choose from

Arizona Daily Star March 21, 1981

Arizona Daily Star March 21, 1981

INCOME TAX REFUND-SALE

Use your REFUND Check for a down payment on one of these quality automobiles.

"WE FINANCE"
OUR OWN CONTRACTS*

PICKUPS

79 Chev Tow Truck	$10,000
79 Ford ½ Ton	$4499
78 El Camino	$4699
78 GMC Sierra 15	$3699
78 Ford F150 4 spd	$3999
78 Ranger F150 AT	$4499
77 Scottsdale ¾ Ton	$4699
77 Ford ½ Ton AC	$3999
77 Ford ¾ Ton Crew Cab	$4499
77 Ford Super Cab ¾ Ton	$4299
76 Chev Custom Deluxe	$3499
76 Ford Custom F100	$3299
75 Dodge Club Cab	$2999
75 Ford ½ Ton	$2799
74 Cheyenne 1 ton	$3499
74 Ranchero	$2299
73 Dodge Club Cab	$1999
73 GMC Sierra ½ Ton	$2499
72 Chevrolet ½ Ton	$2499
71 Dodge ½ Ton	$1799
71 Ford ½ Ton	$1999
70 Ranchero GT	$2199
70 GMC ½ Ton	$1799
69 Ford ½ Ton	$1399
65 Ford ½ Ton	$1299

SMALL TRUCKS

78 Courier	$4999
76 Toyota SR5 Long Bed	$3699
75 Luv 4 spd	$3199
73 Luv 4 spd	$2299

MID-SIZE

79 Malibu Classic 4 Dr	$4999
78 Fairmont AT	$3899
77 Granada 4 Dr.	$3299
76 Dart Swinger Cpe	$2799
76 Granada 4 Dr	$2899
76 Granada Ghia 2 Dr	$3199
75 Nova Cpe 6 cyl	$2999
75 Granada 4 Dr	$2699
75 Comet Cpe	$2299
75 Cutlass Supreme 4 Dr	$2799
75 Valiant Std 6	$2599
74 Century Luxus	$1999
74 Nova 4 Dr	$2699
74 Malibu Classic Cpe	$2499
74 Maverick Grabber 6	$2499
74 Omega AT 6	$1799
74 Cutlass Salon 4 Dr	$1999
74 VW Thing 4 cyl 4 DR	$2199
73 Regal Cpe	$1399
73 Maverick 2 Dr	$2299
73 Gold Duster Cpe	$2099
73 Luxury LeMans	$2299
71 Cutlass Supreme	$2199
71 Duster Cpe	$1999
69 Grand Prix	$1699
[illegible]	$1599

LUXURY CARS

77 Monte Carlo	$3599
77 Cordoba	$3699
76 Cordoba	$3499
75 Monte Carlo	$2999

ERTISING SUPPLEMENT TO THE ARIZONA DAILY STAR/TUCSON CITI

CASH
CAN
BE
YOURS
JUST CALL
889-5333
Place a STAR/CITIZEN CLASSIFIED AD & sell those unwanted items.

AUTOMOTIVE
TRANSPORTATION

200 Autos Wanted

ABLE to buy all type pickups, damaged ca, Jeff's Used Cars, 3612 S. 6th 623-3933, 882-4320

CASH FOR ANY YEAR CAR OR TRUCK RUNNING, WRECKED, JUNKED, TITLED OR NOT. Auto & Truck Sales 792-9656

VAN WYK'S MAZDA
Pays top dollar for clean used cars and small trucks.
1000 E. SPEEDWAY
[illegible]

200 Autos Wanted

ACS Auto Wreckers paying top dollars for cars and trucks, regardless of condition, running or not. 747-8465

SPOT
CASH
FOR YOUR
CAR OR TRUCK
(PAID FOR OR NOT)
"FREE"
Appraisal!
BLUE CHIP
MOTORS
3901 E. SPEEDWAY
PH 795-7770

200 Autos Wanted

50 CARS
NEEDED!
WE PAY
CASH
FOR
1968 TO 1980
CARS-TRUCKS-VANS
Out of state title ok
PAYOFFS MADE
ANYWHERE
TRADE DOWN & GET
CASH BACK!
CITY of CARS
1925 S. Alvernon at 29th St
Buyer on Duty 8:30AM-8PM
PH. 745-2780

TOP $ $ FOR
Used Cars & Trucks
See
TOM CONWAY OR
JIM HUG
PARADISE DATSUN
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792-3311

E

We Want Your Car!!

and to prove it we'll give you . . .

ABSOLUTELY FREE — DINNER FOR TWO

When O'Rielly's buys your car.

100 Pre-owned vehicles to choose from, from 1967's to 1980's. Terms to fit everyone's budget. Choose from your own financing! bank financing! your credit union financing or cash.

Se Habla Espanol

☆ $300 DOWN ☆

1971 Buick Skylark Stk. =X1C275	$2195
1972 Cadillac Fleetwood Stk. =M0538	$1995
1974 Buick Le Sabre Stk. =A2293A	$2295
1971 Buick Estate Wgn Stk. =L1029C	$1795
1973 Ford Gran Torino Stk. =L2171A	$2195
1973 Chev. Laguna Estt Stk. =M5099B	$2305
1972 Ply. Duster Stk. =X1A051R	$1535
1973 Dodge Dart Swngr Stk. =X0L832A	$2195
1972 Ford LTD 2 Dr Stk. =X18149	$2195
1973 Chev. Monte Carlo Stk. =X18158A	$2595
1973 Ply. Fury Stk. =X18151	$2235
1972 Buick Le Sabre Stk. =G3400PC	$1995
1971 Cad Cpe de Vll Stk. =G4258PB	$1895
1974 Chev. Caprice Stk. =X0L746A	$1995
1968 Ford ½ Ton PU Stk. =X015998	$1395
1968 Chev. ½ Ton PU Stk. =L40298	$1295
1969 Chev ½ Ton PU Stk. =X1A098C	$1695
1970 Int'l Travelall Stk. =L71298	$2395

Example: Sale price $2395, cash dn. $300, amt financed $2095, finance charge $734.04, annual percentage rate 31.46, deferred payment price $3149.04, total of payments $2849.04, 24 months @ $118.71 plus tax, license.

☆ $500 DOWN ☆

1975 AMC Gremlin Stk. =M6068A	$2595
1975 Ford LTD S/Wgn Stk. =J9257B	$2395
1974 Chev. Malibu Clssc Stk. =L1037A	$2395
1974 Dodge Dart Swngr Stk. =L2162A	$2295
1976 Merc. Monarch Stk. =X0M861A	$2995
1976 Ford Gran Torino Stk. =L7130A	$2895
1975 Dodge Coronet Cstm Stk. =X1A088	$2395
1975 Merc. Comet Stk. =M3120A	$2695
1974 Olds Cutlass Stk. =X18168A	$2495
1975 Ply Gran Fury Stk. =X19153	$2995
1976 Chev. Impala S/W Stk. =A2310A	$3195
1973 Ply. Satellite Stk. =X1A131	$2695
1974 Chev. Malibu Stk. =X0J596C	$2395
1974 Ply. Duster Stk. =S248PC	$2595
1975 Dodge Ryl Monaco Stk. =X1A028	$2595
1975 Ford Gran Torino Stk. =L2221A	$2495
1974 Pontiac Ventura Stk. =X1A091A	$2495
1975 Ply Fury S/W Stk. =L3179A	$2695

Example: Sale price $2895, cash down $500, amount financed $2395, finance charge $842.04, annual percentage rate 31.46, total of payments $3237.04, deferred payment price $3737.05, 24 months @ $133.71 plus tax & license.

All units subject to prior sale

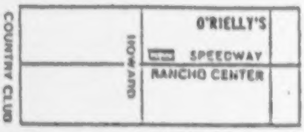
WE FINANCE

We carry our own contracts — With approved down payment & credit. Weekly — Bi Weekly — Monthly Payment Options

For The Winning Edge

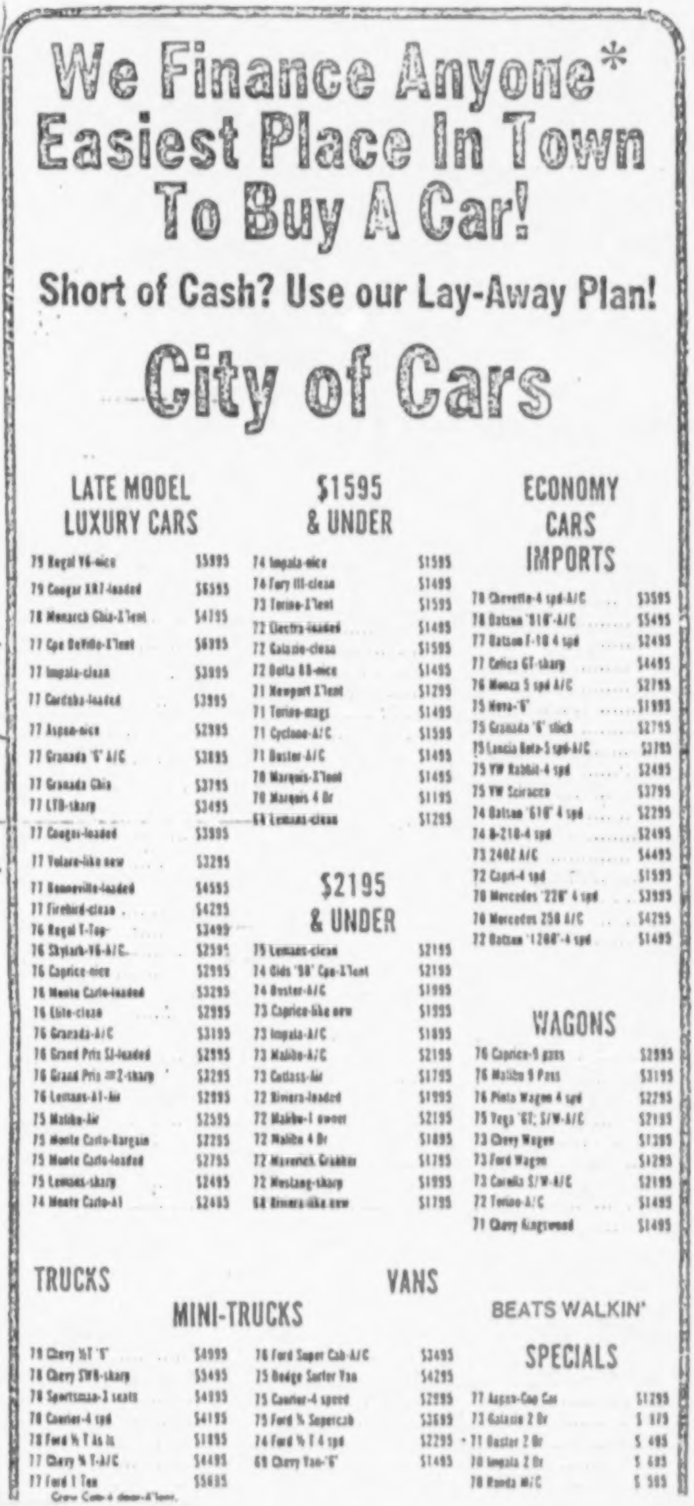
O'RIELLY SPEEDWAY

3313 E. Speedway
881-0233



(F)

April 7, 1981



We Finance Anyone* Easiest Place In Town To Buy A Car!

Short of Cash? Use our Lay-Away Plan!

City of Cars

LATE MODEL LUXURY CARS

79 Regal V6-nice	$5995
79 Cougar XR7-loaded	$6595
78 Monarch Ghia-X'lent	$4795
77 Cpe DeVille-X'lent	$6995
77 Impala-clean	$3995
77 Cordoba-loaded	$3995
77 Aspen-nice	$2995
77 Granada '6' A/C	$3895
77 Granada Ghia	$3795
77 LTD-sharp	$3495
77 Cougar-loaded	$3995
77 Volare-like new	$3295
77 Bonneville-loaded	$4595
77 Firebird-clean	$4295
76 Regal T-Top	$3499
76 Skylark-V6-A/C	$2595
76 Caprice-nice	$2995
76 Monte Carlo-loaded	$3295
76 Elite-clean	$2995
76 Granada-A/C	$3195
76 Grand Prix SJ-loaded	$2995
76 Grand Prix #2-sharp	$3295
76 Lemans-A1-Air	$2995
75 Malibu-Air	$2595
75 Monte Carlo-Bargain	$2295
75 Monte Carlo-loaded	$2795
75 Lemans-sharp	$2495
74 Monte Carlo-A1	$2495

$1595 & UNDER

74 Impala-nice	$1595
74 Fury III-clean	$1495
73 Torino-X'lent	$1595
72 Electra-loaded	$1495
72 Galaxie-clean	$1595
72 Delta 88-nice	$1495
71 Newport X'lent	$1295
71 Torino-mags	$1495
71 Cyclone-A/C	$1595
71 Duster-A/C	$1495
70 Marquis-X'lent	$1495
70 Marquis 4 Dr	$1195
69 Lemans-clean	$1295

$2195 & UNDER

75 Lemans-clean	$2195
74 Olds '98' Cpe-X'lent	$2195
74 Duster-A/C	$1995
73 Caprice-like new	$1995
73 Impala-A/C	$1895
73 Malibu-A/C	$2195
73 Cutlass-Air	$1795
72 Riviera-loaded	$1995
72 Malibu-1 owner	$2195
72 Malibu 4 Dr	$1895
72 Maverick Grabber	$1795
72 Mustang-sharp	$1995
68 Riviera-like new	$1795

ECONOMY CARS IMPORTS

78 Chevette-4 spd-A/C	$3595
78 Datsun '510'-A/C	$5495
77 Datsun F-10 4 spd	$2495
77 Celica GT-sharp	$4495
76 Monza 5 spd A/C	$2795
75 Nova-'6'	$1995
75 Granada '6' stick	$2795
75 Lancia Beta-5 spd-A/C	$3795
75 VW Rabbit-4 spd	$2495
75 VW Scirocco	$3795
74 Datsun '610' 4 spd	$2295
74 B-210-4 spd	$2495
73 240Z A/C	$4495
72 Capri-4 spd	$1595
70 Mercedes '220' 4 spd	$3995
70 Mercedes 250 A/C	$4295
72 Datsun '1200'-4 spd	$1495

WAGONS

76 Caprice-9 pass	$2995
76 Malibu 9 Pass	$3195
76 Pinto Wagon 4 spd	$2295
75 Vega 'GT' S/W-A/C	$2195
73 Chevy Wagon	$1395
73 Ford Wagon	$1295
73 Corolla S/W-A/C	$2195
72 Torino-A/C	$1495
71 Chevy Kingswood	$1495

TRUCKS

VANS

MINI-TRUCKS

79 Chevy ½T '6'	$4995
78 Chevy SWB-sharp	$5495
78 Sportsman-3 seats	$4895
78 Courier-4 spd	$4195
78 Ford ½ T As Is	$1895
77 Chevy ¾ T-A/C	$4495
77 Ford 1 Ton Crew Cab-4 door-X'lent	$5695

76 Ford Super Cab-A/C	$3495
75 Dodge Surfer Van	$4295
75 Courier-4 speed	$2995
75 Ford ¾ Supercab	$3695
74 Ford ½ T 4 spd	$2295
69 Chevy Van-'6'	$1495

BEATS WALKIN'

SPECIALS

77 Aspen-Cop Car	$1295
73 Galaxie 2 Dr	$ 879
71 Duster 2 Dr	$ 495
70 Impala 2 Dr	$ 695
70 Honda M/C	$ 595

(C)

April 7, 1981

200 Automobiles
WE FINANCE

"No Credit Experience is Necessary!"*

WE ESTABLISH YOUR CREDIT!

AMERICAN MOTORS

80 Concord Wgn 4 Cyl	$6000
74 Hornet 2 Dr AT 6	$2099

BUICKS

75 Skyhawk HP Cpe V6	$2999
73 Regal Cpe	$1999
73 LeSabre 4 Dr	$1699
72 Centurion 2 Dr	$1699

CADILLACS

79 El Dorado Cpe	$13,950
78 Cpe de Ville	$8500
76 Seville 4 Dr	$7500
75 Cpe de Ville	$3299
74 Calais 2 Dr	$1499
74 Cpe de Ville	$2199
73 Cpe de Ville	$2299
72 Cpe de Ville	$1899
71 Eldorado	$1999
68 Sdn de Ville	$499
63 Sdn de Ville	$699

CHEVROLETS

79 Malibu Classic 4 Dr	$4999
78 Camaro AT V8	$4999
77 Monte Carlo	$3599
76 Camaro 4 spd V8	$3699
75 Caprice Classic 4 Dr	$2499
75 Monza 2+2 4 spd	$2699
75 Monte Carlo Cpe	$2999
75 Nova Cpe AT 6 cyl	$2999
74 Caprice Classic 4 Dr	$1999
74 Malibu Classic Cpe	$2499
74 Impala Custom 2 Dr	$2299
74 Nova 4 Dr	$2699
73 Impala Custom 2 Dr	$1999
73 Caprice Classic Wgn	$1699
73 Monte Carlo	$2299
71 Camaro AT V8	$1000
71 Impala 4 Dr	$1899

FORDS

78 Fairmont Fttr Cpe 6 cyl	$4199
78 Fairmont 4 Dr V8	$3999
78 Granada Cpe AT 6	$3999
78 LTD II Cpe AT V8	$3499
78 LTD Landau Cpe	$4999
77 Granada 4 DR AT V8	$3299
76 Elite Cpe Split Seat	$3199
76 Mustang II 2+2 AT V8	$2699
76 Granada 4 Dr	$2999
76 Granada Ghia Cpe	$3150
76 Pinto 2 Dr AT	$2499
76 Torino Wgn AT	$2999
75 Granada 4 Dr	$2699
74 Maverick Grbr Cpe 6	$2495
76 Gran Torino Wgn	$2699
74 Mustang II HB AT V6	$2699
74 Pinto Cpe 4 spd	$1599
74 Pinto Runabout AT	$2299
74 Thunderbird Cpe	$2499
74 Torino 4 Dr	$1999
73 Thunderbird	$2499
72 Gran Torino	$1999
72 LTD 2 Dr	$1799
72 Thunderbird	$1499
71 LTD Brougham	$1599
71 Thunderbird	$1999

MERCURYS

76 Montego MX 4 Dr	$1699
74 Comet 2 Dr AT 6	$2199
74 Cougar XR-7 AT V8	$2499
73 Capri Cpe 4 spd V6	$1999
72 Montego MX Cpe	$2299
71 Cougar Cpe	$3099

OLDSMOBILES

76 Cutlass Cpe	$3499
75 Omega Cpe AT V8	$2999
75 Cutlass Supreme 4 Dr	$2299
75 Toronado	$2299

PLYMOUTHS

76 Sport Fury Cpe	$2999
75 Valiant 4 Dr std 6	$2599
73 Gold Duster Cpe AT 6	$2099
66 Fury III 2 Dr	[illegible]

PONTIACS

79 Grand Prix Cpe	$4999
77 Firebird Cpe AT V6	$4499
75 Catalina Wgn	$1999
74 Grand Prix	$2299
73 Catalina 2 Dr	$2199
73 Firebird Cpe 3 spd V8	$2499
72 Catalina 4 Dr	$1299
72 Ventura 3 spd V8	$1999
72 4 Dr Wgn	$1399
72 Catalina 4 Dr	$1699
72 LeMans	$1599
71 Bonneville	$1499
70 Bonneville 4 Dr	$1299

TRUCKS

79 Chev ¾ Ton AT V8	$5999
79 Chev 1 Ton Tow Truck	$10,000
79 Ford ½ ton 3 spd 6	$4499
78 El Camino AT V8	$4699
78 Ford Courier AT 4	$4999
78 Ford Ranger Lariat 150	$4499
77 Chev Luv 4 spd 4	$3999
77 Chev Scottsdale ½ ton AT	$4699
77 Ford ½ Ton AT V8	$3999
77 Ford Crew Cab ¾ Ton	$4499
77 Ford Super Cab ¾ Ton	$4299
76 Chev Cstm Deluxe ½ ton	$3499
76 Ford Custom ½ Ton	$3299
75 Luv 4 spd	$3199
75 Scottsdale Sub 4x4	$3699
75 Ford ½ Ton 3 spd V8	$2799
74 Ford ½ Ton 5 spd V8	$1499
74 El Camino Classic	$2599
74 Travelall AT V8	$2199

VOLUME DEALER

FRESH ARRIVALS DAILY

"We Pay Cash For Cars"

*with required down payment

BLUE CHIP MOTORS, Inc.

3901 E. Speedway Ph 327-6551

(H)

April 7, 1981

50 CARS
NEEDED!

WE PAY CASH

FOR
1968 TO 1980
CARS-TRUCKS-VANS
Out of state title ok
PAYOFFS MADE
ANYWHERE

TRADE DOWN & GET
CASH BACK!

CITY of CARS

1925 S. Alvernon at 29th St
Buyer on Duty 9:30AM-8PM
PH 745-2780

SPOT CASH

FOR YOUR
CAR OR TRUCK
(PAID FOR OR NOT)

"FREE" Appraisal!

BLUE CHIP MOTORS

3901 E. SPEEDWAY
PH 795-7290

PROMISSORY NOTE AND DISCLOSURE STATEMENT

LENDER

MIDLAND FINANCE LOAN CO.
7541 N. WESTERN AVENUE
CHICAGO, ILLINOIS 60645

LICENSED UNDER THE ILLINOIS CONSUMER INSTALLMENT LOAN ACT

DATE OF THIS NOTE July 7, 1982

BORROWERS LOAN NO. [illegible]

NAMES AND ADDRESSES	SOCIAL SECURITY NUMBE		
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]			
Chicago, Il. 60623			

FEDERAL TRUTH-IN-LENDING DISCLOSURE STATEMENT

ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate.	FINANCE CHARGE The dollar amount the credit will cost you.	AMOUNT FINANCED The amount of credit provided to you or on your behalf.	TOTAL OF PAYMENTS The amount you will have paid after you have made all payments as scheduled.
48.00 %	$ 844.01	$ 1405.99	$ 2250.00

Your payment schedule will be:

No. of Payments	Amount of Payments	When Payments are Due
25	$ 90.00	monthly beginning 8/7/82
	$	
	$	

SECURITY: You are giving a security interest in:
☐ Motor Vehicle ______ Year and Make ______ Serial No.
☐ Mortgage or trust deed on Borrower's real property at above address.
☒ Household and consumer goods located at Borrower's address stated above.
☒ Wage Assignment(s) ☐ Other (Describe) ______

LATE CHARGE: If payment is late a delinquency charge will be charged at the agreed rate on any delinquent installment after the due date originally scheduled herein.

PREPAYMENT: If you pay off early you will be entitled to a refund of part of the Finance Charge.

See the Note terms below and contract documents for any additional information about non-payment, default, any required repayment in full before the scheduled date, prepayment refunds and penalties and further information about security interests.

Itemization of Amount Financed

1. $ — paid to Midland Finance Loan Co. on Account No. ______
2. $ — paid to Midland Finance Co. on Account No. ______

Amount paid to others on your behalf:

3. $ — to ______
4. $ — to ______
5. $ — to ______
6. $ — to ______
7. $ 235.00 paid directly to you and forwarded at your direction to Central National Insurance Co. of Omaha for $10,000 Accidental Deat & Dismemberment Policy
8. $ — paid directly to you and forwarded at your direction to ______ for ______
9. $ 30.47 Credit Life Insurance
10. $ 101.25 Credit Disability Insurance
11. $ — ______
12. $ 8.00 Official fees (for perfecting or releasing security)
13. $ 1031.27 Check or cash given to you directly

$ 1405.99 Amount financed (sum of 1 through 13)

FOR VALUE RECEIVED Borrower(s), jointly and severally, promise to pay to the order of Lender at its above stated office the Total of Payments stated above in consecutive monthly installments beginning on the due date of the first installment shown above and continuing on the same day of each month thereafter until the Total of Payments is fully paid. The Finance Charge has been precomputed at the Annual Percentage Rate above stated agreed to by the Lender and the Borrower(s) on the scheduled unpaid principal balances of the Amount Financed. The Finance Charge computed as herein stated has been added to the Amount Financed.

DEFAULT CHARGES. The undersigned agrees to pay a delinquency charge at the agreed rate on any delinquent installment outstanding after the due date originally scheduled herein. If two or more installments are delinquent on any installment due date, the loan contract balance may, at the option of the holder hereof, be reduced by the rebate which would be required for prepayment in full on such installment date, and thereafter the simple interest equivalent of the prepaid Finance Charge may be collected on the actual unpaid balances of the loan contract (as reduced by the rebate) for the time that such balances are actually outstanding until the loan contract is fully paid. After default, Borrower(s) agrees to pay reasonable attorneys' fees incurred in legal proceedings to collect this note or to realize on any security.

DEFERMENT CHARGE: Borrower(s) agrees that Lender may charge additional interest for a one month's deferment equal to the difference between the rebate that would be required for prepayment in full as of the scheduled due date of the deferred installment and the rebate that would be required for prepayment in full as of one month prior to said date. The rebate for prepayment in full after deferment interest has been charged shall be calculated upon the standard precomputed interest for the number of months of the loan contract from the installment date nearest the date of prepayment to the deferred due date of the final installment. Any uncollected portion of deferment interest may be deducted from the standard rebate so computed.

ACCELERATION PROVISION: If Borrower(s) shall default in the payment of any installment hereof when due, or upon the occurrence of any event of default under the provisions of the security agreement or real estate mortgage executed herewith, Lender may, at Lender's option, and without notice or demand, accelerate the entire unpaid balance of the Total of Payments and accrued charges. In the event of acceleration, Borrower(s) shall be credited with the same rebate of unearned Finance Charge as for voluntary prepayment. After default, Borrower(s) agrees to pay reasonable attorneys' fees incurred in legal proceedings to collect this note or to realize on any security.

REBATE FOR PREPAYMENT: Borrower(s) may prepay this note in full (by cash, renewal or refinancing, or a new loan) and receive a statutory rebate equal to that proportion of the original Finance Charge for the loan which the sum of the monthly balances scheduled to follow such prepayment in full bears to the sum of all the monthly balances, both sums to be determined according to the payment schedule originally contracted for. This statutory computation employs the "sum of the digits" method, also known as the "Rule of 78ths". Prepayment in full will reduce both the Finance Charge and Insurance Charge for the loan.

INSURANCE AGREEMENT

Property Insurance may be required by Lender. Borrower(s) may choose the person through whom the insurance is to be obtained. If such insurance is to be obtained through Lender, the cost for the term of the credit will be $ 0 . Property Insurance provided by Lender may be cancelled within 15 days of the date of the loan by written request signed by all obligors upon presentation to Lender of reasonably acceptable replacement insurance coverage with appropriate mortgage clause in favor of Lender. In the event of such cancellation and on evidence of replacement coverage, the entire premium cost, together with the portion of Finance Charge applicable thereto, shall be refunded to the Borrower(s) and the insurance shall be voided from the date of its inception.

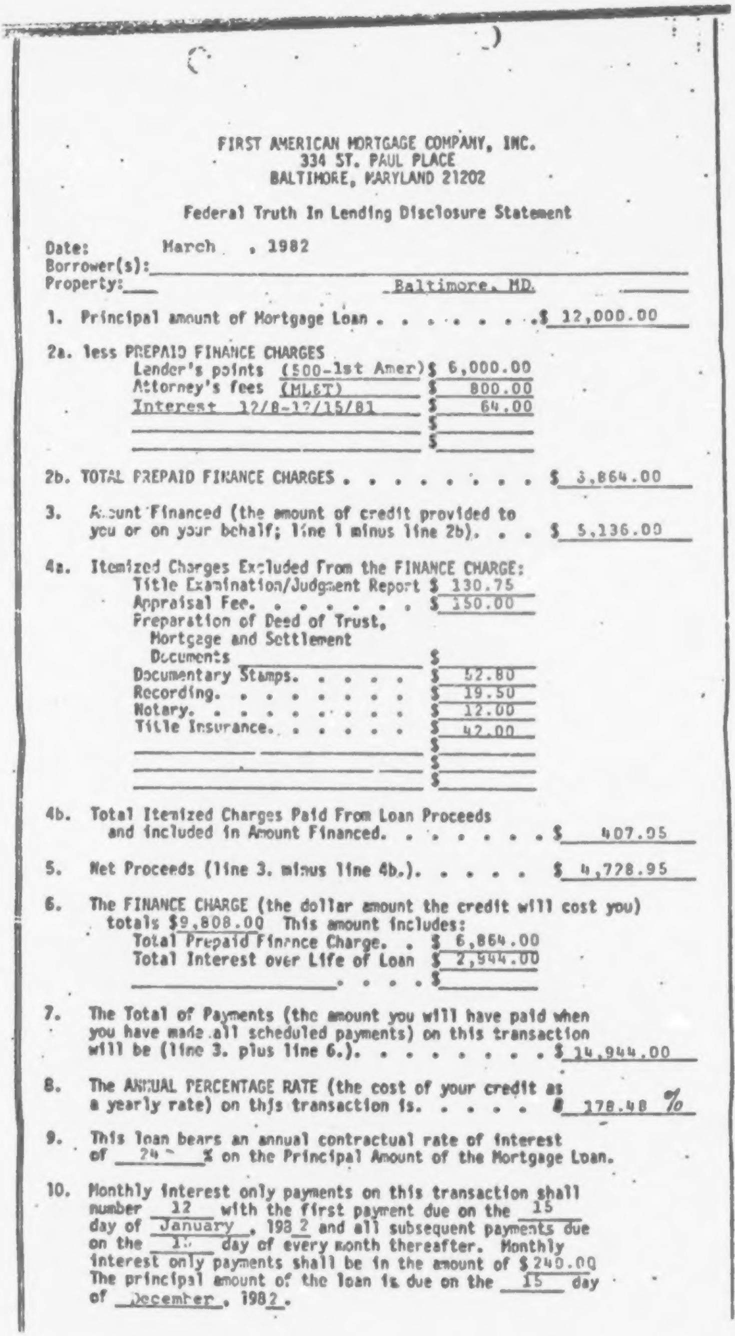
Credit Insurance is not required by Lender nor is it a factor in approval of the extension of credit. No credit insurance is to be provided unless the Borrower(s) signs the appropriate authorization below. Credit life and credit accident and health insurance provided by Lender may be cancelled within 15 days of the date of the loan by written request signed by all obligors. In the event of such cancellation the entire premium cost together with the portion of Finance Charge applicable thereto shall be refunded to the Borrower(s) and the insurance shall be voided from date of its inception. Group Credit Insurance is available for the term of the credit at the following costs:

Credit Life Insurance $ 30.47 Credit Disability Insurance $ 101.25

I do NOT want Credit Life or Disability Insurance	I/We desire Credit Life Insurance	I desire Credit Life and Disability Insurance
(Signature)	(Signature)	
(Signature)	(Signature)	(Signature)

The undersigned severally waive demand for payment, presentment for payment and notice of dishonor and the extension of the time of payment without n... The construction, validity and effect of this note shall be governed by the laws of Illinois. The undersigned acknowledge receipt of a duplicate of this instru... before consummation of the loan.

WITNESSES ______ (Borrower)



FIRST AMERICAN MORTGAGE COMPANY, INC.
334 ST. PAUL PLACE
BALTIMORE, MARYLAND 21202

Federal Truth In Lending Disclosure Statement

Date: March , 1982
Borrower(s):
Property: Baltimore, MD.

1. Principal amount of Mortgage Loan . . . . $ 12,000.00

2a. less PREPAID FINANCE CHARGES

Lender's points (500-1st Amer)	$ 6,000.00
Attorney's fees (ML&T)	$ 800.00
Interest 12/8-12/15/81	$ 64.00
	$
	$

2b. TOTAL PREPAID FINANCE CHARGES . . . . $ 3,864.00

3. Amount Financed (the amount of credit provided to you or on your behalf; line 1 minus line 2b). . . $ 5,136.00

4a. Itemized Charges Excluded From the FINANCE CHARGE:

Title Examination/Judgment Report	$ 130.75
Appraisal Fee.	$ 150.00
Preparation of Deed of Trust, Mortgage and Settlement Documents	$
Documentary Stamps.	$ 52.80
Recording.	$ 19.50
Notary.	$ 12.00
Title Insurance.	$ 42.00
	$
	$
	$

4b. Total Itemized Charges Paid From Loan Proceeds and included in Amount Financed. . . . . $ 407.95

5. Net Proceeds (line 3. minus line 4b.). . . . . . $ 4,728.95

6. The FINANCE CHARGE (the dollar amount the credit will cost you) totals $9,808.00 This amount includes:

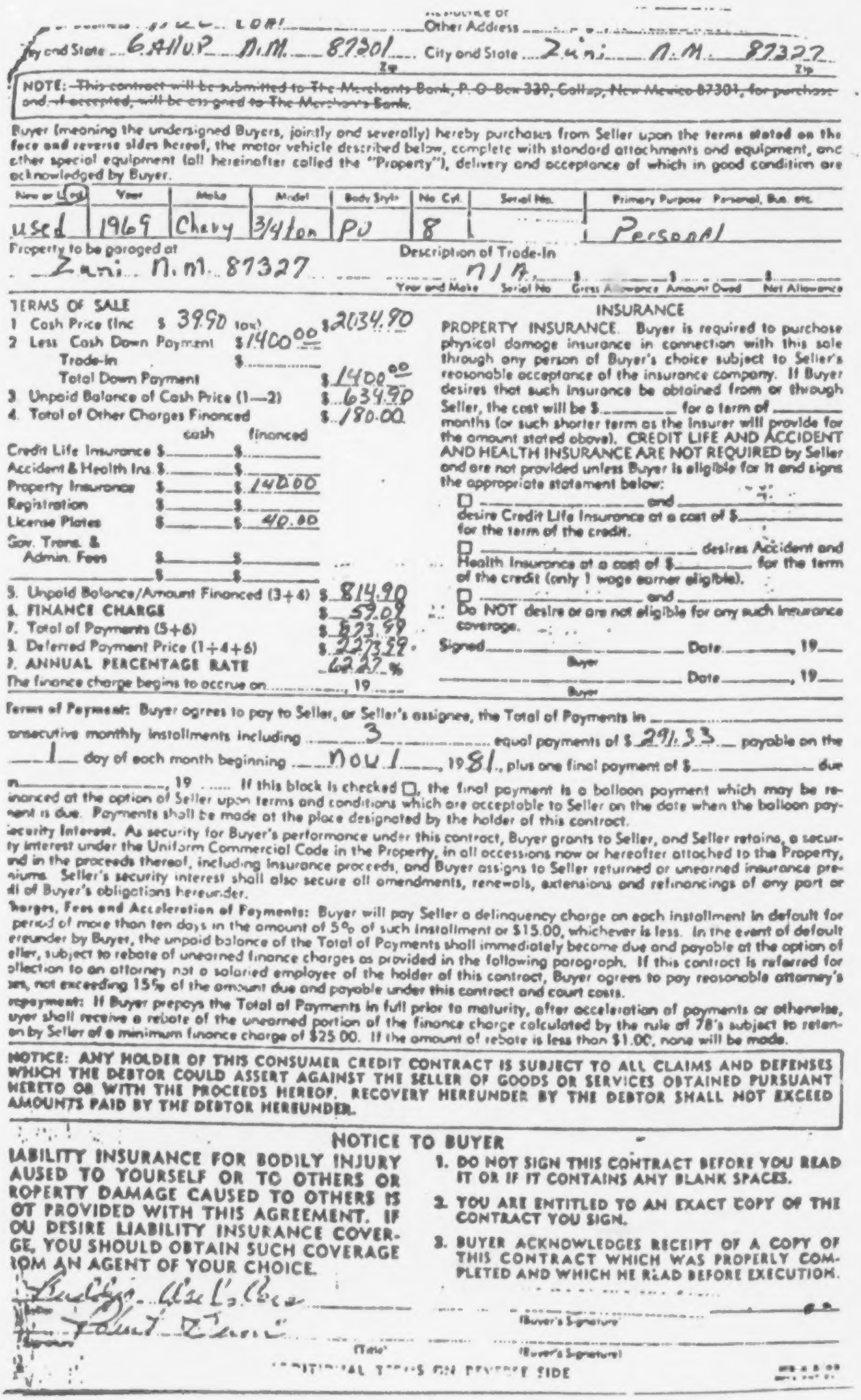
Total Prepaid Finance Charge. .	$ 6,864.00
Total Interest over Life of Loan	$ 2,944.00
. . . .	$

7. The Total of Payments (the amount you will have paid when you have made all scheduled payments) on this transaction will be (line 3. plus line 6.). . . . . $ 14,944.00

8. The ANNUAL PERCENTAGE RATE (the cost of your credit as a yearly rate) on this transaction is. . . . . $ 178.48 %

9. This loan bears an annual contractual rate of interest of 24 % on the Principal Amount of the Mortgage Loan.

10. Monthly interest only payments on this transaction shall number 12 with the first payment due on the 15 day of January , 1982 and all subsequent payments due on the 1 day of every month thereafter. Monthly interest only payments shall be in the amount of $240.00 The principal amount of the loan is due on the 15 day of December , 1982.



[illegible] LOA! [illegible] or Other Address [illegible]

City and State 6AllUP N.M. 87301 Zip City and State Zuni N.M. 87327 Zip

NOTE: ~~This contract will be submitted to The Merchants Bank, P. O. Box 339, Gallup, New Mexico 87301, for purchase~~ and ~~if accepted, will be assigned to The Merchants Bank.~~

Buyer (meaning the undersigned Buyers, jointly and severally) hereby purchases from Seller upon the terms stated on the face and reverse sides hereof, the motor vehicle described below, complete with standard attachments and equipment, and other special equipment (all hereinafter called the "Property"), delivery and acceptance of which in good condition are acknowledged by Buyer.

New or [✓ Used]	Year	Make	Model	Body Style	No. Cyl.	Serial No.	Primary Purpose Personal, Bus. etc.
used	1969	Chevy	3/4 ton	PU	8		Personal

Property to be garaged at Zuni N.M. 87327

Description of Trade-In N/A $ $ $

Year and Make Serial No Gross Allowance Amount Owed Net Allowance

TERMS OF SALE

1 Cash Price (Inc $ 39.90 tax)			$2034.90
2 Less Cash Down Payment		$1400.00	
Trade-In		$	
Total Down Payment			$1400.00
3 Unpaid Balance of Cash Price (1—2)			$634.90
4. Total of Other Charges Financed			$180.00
	cash	financed	
Credit Life Insurance	$	$	
Accident & Health Ins.	$	$	
Property Insurance	$	$140.00	
Registration	$	$	
License Plates	$	$40.00	
Gov. Trans. & Admin. Fees	$	$	
	$	$	
5. Unpaid Balance/Amount Financed (3+4)			$814.90
6. FINANCE CHARGE			$59.09
7. Total of Payments (5+6)			$873.99
8. Deferred Payment Price (1+4+6)			$2273.99
9. ANNUAL PERCENTAGE RATE			62.27 %

The finance charge begins to accrue on ________, 19___

INSURANCE

PROPERTY INSURANCE. Buyer is required to purchase physical damage insurance in connection with this sale through any person of Buyer's choice subject to Seller's reasonable acceptance of the insurance company. If Buyer desires that such insurance be obtained from or through Seller, the cost will be $________ for a term of ________ months (or such shorter term as the insurer will provide for the amount stated above). CREDIT LIFE AND ACCIDENT AND HEALTH INSURANCE ARE NOT REQUIRED by Seller and are not provided unless Buyer is eligible for it and signs the appropriate statement below:

☐ ________ and ________ desire Credit Life Insurance at a cost of $________ for the term of the credit.

☐ ________ desires Accident and Health Insurance at a cost of $________ for the term of the credit (only 1 wage earner eligible).

☐ ________ and ________ Do NOT desire or are not eligible for any such insurance coverage.

Signed ________ Buyer Date ________, 19___

________ Buyer Date ________, 19___

Terms of Payment: Buyer agrees to pay to Seller, or Seller's assignee, the Total of Payments in ________ consecutive monthly installments including 3 equal payments of $291.33 payable on the 1 day of each month beginning Nov 1, 1981, plus one final payment of $________ due on ________, 19 ...... If this block is checked ☐, the final payment is a balloon payment which may be refinanced at the option of Seller upon terms and conditions which are acceptable to Seller on the date when the balloon payment is due. Payments shall be made at the place designated by the holder of this contract.

Security Interest. As security for Buyer's performance under this contract, Buyer grants to Seller, and Seller retains, a security interest under the Uniform Commercial Code in the Property, in all accessions now or hereafter attached to the Property, and in the proceeds thereof, including insurance proceeds, and Buyer assigns to Seller returned or unearned insurance premiums. Seller's security interest shall also secure all amendments, renewals, extensions and refinancings of any part or all of Buyer's obligations hereunder.

Charges, Fees and Acceleration of Payments: Buyer will pay Seller a delinquency charge on each installment in default for a period of more than ten days in the amount of 5% of such installment or $15.00, whichever is less. In the event of default hereunder by Buyer, the unpaid balance of the Total of Payments shall immediately become due and payable at the option of Seller, subject to rebate of unearned finance charges as provided in the following paragraph. If this contract is referred for collection to an attorney not a salaried employee of the holder of this contract, Buyer agrees to pay reasonable attorney's fees, not exceeding 15% of the amount due and payable under this contract and court costs.

Prepayment: If Buyer prepays the Total of Payments in full prior to maturity, after acceleration of payments or otherwise, Buyer shall receive a rebate of the unearned portion of the finance charge calculated by the rule of 78's subject to retention by Seller of a minimum finance charge of $25.00. If the amount of rebate is less than $1.00, none will be made.

NOTICE: ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

NOTICE TO BUYER

LIABILITY INSURANCE FOR BODILY INJURY CAUSED TO YOURSELF OR TO OTHERS OR PROPERTY DAMAGE CAUSED TO OTHERS IS NOT PROVIDED WITH THIS AGREEMENT. IF YOU DESIRE LIABILITY INSURANCE COVERAGE, YOU SHOULD OBTAIN SUCH COVERAGE FROM AN AGENT OF YOUR CHOICE.

1. DO NOT SIGN THIS CONTRACT BEFORE YOU READ IT OR IF IT CONTAINS ANY BLANK SPACES.
2. YOU ARE ENTITLED TO AN EXACT COPY OF THE CONTRACT YOU SIGN.
3. BUYER ACKNOWLEDGES RECEIPT OF A COPY OF THIS CONTRACT WHICH WAS PROPERLY COMPLETED AND WHICH HE READ BEFORE EXECUTION.

Seller ________ (Buyer's Signature)

Signature ________ (Title) (Buyer's Signature)

ADDITIONAL TERMS ON REVERSE SIDE

CALIFORNIA LOAN BROKER SECURITY AGREEMENT

LENDER - SECURED PARTY
ORIGINAL

THRIFT AGREEMENT
PACIFIC THRIFT AND LOAN
90310 S. La Brea (213)678-9073
Inglewood, Ca. 90310
License No. 973-3800

BORROWERS - DEBTORS

LOAN NO.

DATE OF THIS LOAN April 9, 1980	FIRST INSTALLMENT DUE DATE: July 9, 1980		OTHERS: SAME DAY OF EACH ~~MONTH~~ QUARTERLY	FINAL INSTALLMENT DUE DATE: April 9, 1983

AMOUNT FINANCED:	FINANCE CHARGE:	ANNUAL PERCENTAGE RATE	TOTAL OF PAYMENTS:	PAYABLE IN 12 CONSECUTIVE ~~MONTHLY~~ QRTLY INSTALLMENTS	FIRST INSTALLMENT:	OTHERS:
$36,006.75	$22,874.97	58.60 %	$58,881.72		$4,906.81	$4,906.8

GREED RATE OF CHARGE: 2.8% per month on the unpaid Principal Balance.
lus a Loan Fee of $7,219.00.

Debtor(s) named above grant and convey unto Secured Party, a security interest in the following described personal property, and all other goods and chattels similar in nature to said described property, together with accessions and in addition Debtor(s) convey to Secured Party a security interest in all proceeds thereof, to secure repayment of the loan described above, as well as all additional sums which may be advanced and expenditures which may be made by Secured Party for or on behalf of Debtor(s) together with charges on all of said sums at the rate specified above, provided that the total amount secured by this Security Agreement shall not exceed the aggregate sum of $10,000.00 over and above the amount financed at any one time.

Debtor(s) shall keep said property free from all liens, and insured against loss by fire, theft and collision in the case of motor vehicles, and against loss by fire in the case of other chattels, and shall not remove the motor vehicle from this state or remove the herein described furniture from the address above listed without the Secured Party's written permission. Should Secured Party, subsequent to the date and prior to the satisfaction of this security agreement, pay taxes, assessments or liens of any kind or character or pay premium on authorized insurance, such advances shall become a principal part of said note, shall be secured by this security agreement, and shall bear charges at the rate provided for in said note. Neither loss of nor injury to said property shall relieve Debtor(s) from his obligations hereunder.

Debtor(s) warrants that he is the sole owner of said property, free from all liens except as set forth herein. The parties hereto agree that time is of the essence of this Agreement and acceptance by the Secured Party of any payment required hereunder, after the same is due, shall not constitute a waiver of this or any other provision of this Security Agreement. Any failure of the Secured Party to enforce any of its rights or remedies hereunder shall not be a waiver of its right to do so thereafter. Whenever the context so requires, plural words shall be construed as singular and vice versa.

Should Debtor(s) fail or neglect to comply with any of the terms and conditions of any note secured by this Security Agreement, Secured Party at its option, without demand but upon notice, may declare the whole amount unpaid thereunder to be immediately due and payable; and Secured Party may at its option, according to law, immediately take possession of any or all of said property. Secured Party may require the Debtor(s) to assemble the collateral and make it available to Secured Party at a place to be designated by the Secured Party which is reasonably convenient to both parties. Should Secured Party take possession of said property, Secured Party may sell said property at public or private sale, without prior demand of performance, which demand is hereby waived, provided not less than five days' written notice of the time and place of any public sale, or of the time on or after which any private sale or disposition is to be made, shall have been given by registered or certified mail, postage prepaid, and in accordance with the provisions of Section 9504(3) of the Uniform Commercial Code. Said property may be sold upon such terms and in such manner as the Secured Party may in good faith determine, in a reasonably commercial manner, and, subject to the limitations of said Section 9504(3) of the Uniform Commercial Code, Secured Party may become the purchaser thereof. In the event of such sale, Secured Party shall apply the proceeds thereof to the payment of all or any of the obligations hereby secured, and the balance then remaining, if any, to the Debtor(s). In the event of any deficiency, Debtor(s) agrees to pay the same on demand.

Year Model	Trade Name	Body Type	Serial No. — Motor No. — I.D. No.	License No.	No. Cyls.
	N	O	N	E	

THIS LOAN IS SECURED BY A DEED OF TRUST OF EVEN DATE AND RECORDED SEPARATELY ON PROPERTY COMMONLY KNOWN AS:
Inglewood, California 90301.

W
Jw

ANNUAL PERCENTAGE RATE **34.07**** %

The ANNUAL PERCENTAGE RATE is subject to increase or decease because the agreed rate of interest charged on the loan may change under the following conditions. The interest rate may be increased or decreased from time to time in order to make the interest rate equal to a rate per annum of FOURTEEN AND SEVEN***** percent (14.07****%) above the prime lending rate charged by the Bank of America at its principal office on 90-day unsecured commercial loans to its most creditworthy commercial borrowers, as changes in that prime lending rate may be made and announced by the Bank of America from time to time. However at no time will the interest rate be less than the initial agreed rate of charge stated herein. There are no limits on the number or frequency of changes in the interest rate that may be made. Changes in the interest rate will be effective on and as of the date they are made. Failure to increase the interest rate or to make the maximum increase possible at any time does not waive the right to make these increases at any future date.

A change in the interest rate will result in a corresponding increase or decrease in the amount of the installment payments. Written notice of any such change in the installment payment amount will be given by mail at least ten (10) days before the due date of the next installment payment.

W
Jw

Example: Based on the original amount financed and the number of installment payments shown herein, if a .25% (¼ of 1%) increase in the interest rate on the loan were made today, the installment payment amount would increase from $ 4,906.81*** (estimated) to $ 4,922.48***** (estimated).

x ______________________ WITNESS ______________________ BORROWER-DEBTOR

EXHIBIT C

CALIFORNIA LOAN BROKER TIL DISCLOSURE

an arranged by Pro.Lease Funding nated by Federal Law as Creditor. Additional creditor is a lender to be procured by whose identity is not known as of the execution of this document. Pro.Lease Fundings this disclosure on behalf of the company and on behalf of: .... lender-creditor, whose name(s) will be inserted here-in above prior to the close of escrow.

A. AMOUNT FINANCED

1) Appraisal fees	none
2) Escrow fees	550.00
3) Costs of investigating or guaranteeing title	224.60
4) Notary fees	none
5) Recording fees	10.00
6) Credit Investigation fees	none
7) Charges or premiums for fire insurance if obtained through Creditor. The borrower may choose the agent through which the insurance is to be obtained	none
8) Premium for Credit Life insurance for term of loan. (Not required by Creditor for approval of loan)	none
9) Premium to Disability Insurance for term of loan. (Not required by Creditor for approval of loan)	none
10) Assumption, transfer, forwarding and Beneficiary Statement fees	20.00
11) Due on prior liens, including reconveyance, etc., fees:	
Imperial Bank	48,335.00
	none
	none
12) Document Preparation	none
13) Other payments on order of Borrower:	none
Tax Service Contract	20.00
	none
14) ESTIMATED BALANCE TO BE DELIVERED TO BORROWER	0.00
15) Amount Financed (sum of Items 1 through 14)	49,159.60

B. FINANCE CHARGE

16) Broker's Commission earned in full for services rendered	11,540.00
Credit to Commission	(3,000.00)
17) Reconveyance Fee (This is an estimate based upon the current charges of the Trustee named in the Deed of Trust; the named Trustee may be changed by the lender at any time and the Trustee's charges are subject to change)	none
18) Interest for period of the loan (Simple annual rate of 20 %)	11,540.01
Accruing from date of deposit of loan funds in escrow	none
19) Prepaid interest from date of deposit of loan funds in escrow	none
20) Prepaid interest and or principal prior to close of escrow to pre-pay loan payments	none
21) FINANCE CHARGE (sum of Items 16 through 20)	23,080.01

C. ANNUAL PERCENTAGE RATE on the amount financed is 45.23 %

D. LOAN TERMS: This loan is a ☐1st ☒2nd ☐3rd Trust Deed. Other (describe):

1) Principal sum of Note (sum of items 15, 16, 19 & 20) 57,700.00

2) No. of installments ...11.... Amount of each installment....$961.66......... Due date of payments: The first payment is due on either the 5th or 15th of each calendar month, which will be determined at the close of escrow, which will not be more than 45 days or less than 30 days from the date of closing escrow, subsequent payments are made on the same day of each month thereafter. A Balloon Payment in the amount of..$58,661.75 is due on the. 12th...month after close of escrow.

Late Charge: If any installment is delinquent more than 10 days, the late charge for 1st Trust Deed loans less than $20,000 or Junior liens less than $10,000 is $5.00 or 10% of the delinquent payment, whichever is larger; for 1st Trust Deed loans of $20,000 or more, or Junior liens of $10,000 or more, the late charge is $5.00 or 6% of the payment, whichever is larger.

Prepayment Privilege: Privilege is reserved on any installment due date, to repay in whole or in part at any time provided an amount not exceeding 20% of the unpaid balance may be prepaid in any 12 month period and I(we) promise to pay a prepayment charge of any amount prepaid in any 12 month period in excess of 20% of the unpaid balance of 6 months advance interest on the amount prepaid on said excess.

Check box if applicable. ☐

Extension Agreement; The Balloon Balance due at maturity may be extended upon payment of a fee to broker of not more than.................% of the balance due, provided that the note is repaid in accordance with the terms contained therein, and that broker has obtained the consent of the lender.

E. TOTAL OF PAYMENTS 69,240.01

Borrower understands that third persons such as but not limited to a title company may rely upon this representation and represents I(we) have read all of the above terms, and that the matters recited therein are true, and that I(we) have received a copy thereof on ....19.81...., and that borrower does☐ does not ☐ reside or intend to reside on the premises described as security for this

x.. x..

/

LOAN STATEMENT MADE IN COMPLIANCE WITH FEDERAL LAW

Loan secured by Trust Deed on 1816 South Prudence Place, Tucson, Arizona 85710

The name of the lender is not at this time known. Upon ascertaining same, it will be furnished to you.

Arranged by Union Home Loans Designated by Federal Law as creditor.

FINANCE CHARGE, accruing from date of deposit of Loan funds in escrow:

A. AMOUNT FINANCED:

1.	Appraisal fees	$ 40.00
2.	Credit investigation fees	$ 5.00
3.	Notary	$ -0-
4.	Recording fees	$ 6.00
5.	Costs of guaranteeing or investigating Title	$ 40.00
6.	Tax service for period of loan	$ -0-
7.	Fire insurance premiums	$ -0-
8.	Due on prior liens, including reconveyance, etc.	$ -0-
9.	Due other creditors	$ -0-
10.	Assumption, transfers, forwarding and beneficiary statement fees	$ -0-
11.	Accident & Health and/or Credit Life Insurance ☐ A & H Payment Ins. $ 99.96 No. Months 12 Premium $ 2.19 ☐ Life Amount Ins. $ 1,108.29 No. Months 13 Premium $ 19.24 Total	$ 21.43
12.	Other payments on order of borrower Associated Mortgage	$ 390.00
	WLS 903926	$ 259.57
13.		$ -0-
14.	Estimated to borrower	

AMOUNT FINANCED: (Items 1 – 14 incl.) $ 762.00

B. FINANCE CHARGE:

15. The total of the bonuses, brokerage, or commissions contracted for or to be received by any person for negotiating, procuring or arranging or making such a loan. (Prepaid FINANCE CHARGE.) Earned in full for services rendered $ 180.00

Broker to absorb (-0-) $ 180.00

15 (a) Escrow

A.	Basic escrow fee	$ 38.00
B.	Drawing payoffs	$ -0-
C.	Verifying prior encumbrances	$ -0-
D.	Handling demands and payoffs	$ -0-
E.	Drawing documents	$ 20.00

TOTAL ESCROW FEE $ 58.00

LOAN TOTAL (Items 1 – 15a)

This is principal of note $ 1,000.00

16. Interest for period of Loan $ 108.29

Privilege is reserved, on any installment due date, to pay in full all of the above recited obligations by paying a prepayment consideration equal to 10% of said unpaid obligations, or the maximum permitted by law, EXCEPT if the security for said obligations is a single family, owner-occupied dwelling, privilege is reserved to prepay in whole or in part at anytime provided an amount not exceeding 20% of the unpaid balance may be prepaid in any 12 month period and I promise to pay a prepayment charge on any amount prepaid in any 12 month period in excess of 20% of the unpaid balance of 6 month's advance interest in the amount prepaid on said excess. Interest accrues from date lenders' funds are deposited in escrow and the first payment on the note is generally due within thirty days after the close of escrow.

FINANCE CHARGE (Line 15 to Line 16) $ 346.29

C. ANNUAL PERCENTAGE RATE: 37.00 %

D. LOAN TERMS:

Rate of interest is 10% per year on unpaid balance. Installments: Number 13 Amount: 12 @ $ 8.33 plus balloon payment of $ 1,008.33 Total of payments 1,108.29

Due date of each payment ______________________.

I promise to pay Servicing Agent a late payment charge of $5 or 10% of installment due of principal and interest, whichever is greater; provided however on First Trust Deed loans of $20,000 or more, and for Junior Lien loans of $10,000 or more, the following clause governs: $5 or 6% of installment due of principal amount, no late payment charge will be made if the installment is paid or tendered in full within 10 days after its scheduled due date.

Upon any default of this obligation or obligations of said Deed of Trust, the balance of all said obligations, at the option of the holder, shall be immediately due and payable.

Borrower understands that third persons, such as but not limited to a Title Company may rely upon this representation and represents he has read all of the above: That the matters recited therein are true: That he received a copy thereof on Sept. 20, 1979, and that the borrower does XXX reside or intends to reside in the premises described as security for this Loan.

AS INDICATED IN ITEM #11 ABOVE, I DESIRE ACCIDENT AND HEALTH AND OR CREDIT LIFE INSURANCE. THE TOTAL PREMIUN IS $ 21.43 I UNDERSTAND SUCH COVERAGE IS NOT A REQUIREMENT OF THIS LOAN.

Refino C. Gonzales Jr.
SIGNATURE OF INSURED BORROWER

Dated: SEPTEMBER 20, 1979

x Refino C. Gonzales Jr.
REFINO C. GONZALES, JR.

x ______________________

x Mary A. Gonzales
MARY A. GONZALES

Escrow Number ______________

ONZALES LOAN NO. FOUR

(BORROWER [illegible]

BORROWER'S NAME AND ADDRESS
[redacted]
501 M. ST
BWK., GA
DATE OF LOAN 09 25 78

LENDER AND ADDRESS
FIRST FINANCE COMPANY
606 GLOUCESTER STREET
BRUNSWICK, GEORGIA 31520

LOAN NUMBER 01770
PREPAID FINANCE CHARGE $ 10.56

FINANCE CHARGE	ANNUAL PERCENTAGE RATE	AMOUNT FINANCED	TOTAL OF PAYMENTS	
$ 35.69	106.21 %	$ 108.31	$ 144.00	[redacted]

1. The "amount financed" reported above is comprised of the following individually itemized amounts disbursed to or on behalf of the borrower:

(a) Amount Disbursed to Borrower:	$ 104.49
(b) Amount Disbursed to Others:	$ NONE
	$ NONE
	$ NONE
(c) Property Insurance:	$ 1.32
(d) Auto Insurance:	$ NONE
(e) Filing Fee:	$ NONE
(f) Insurance in Lieu of Recording:	$ 2.50

filing fee in addition!

(g) Renewal of prior note:
Unpaid Balance of Prior Note $ NONE

Int $	NONE	Loan Fee $	NONE
Life $	NONE	A & H $	NONE
Auto $	NONE	Property $	NONE
[illegible] $	NONE	Total $	NONE

Amount to be Renewed $ NONE
Late charges on Prior Note $ NONE
TOTAL $ 108.31

2. The "finance charge" reported above is comprised of the following described amounts:

(a) Interest:	$ 5.28
(b) Loan Fee:	$ 10.56
(c) Life Insurance:	$ 1.12
(d) Accident and Health Insurance:	$ 6.73
(e) Maintenance Charge Collectible:	$ 12.00
TOTAL	$ 35.69

3. Number, Amount and Due Dates of Payments: This loan is payable in 5 consecutive monthly installments of $ 24.00 commencing on 10 25 and due on the same date of each succeeding month plus a final installment of $ 24.00 due on 03 25 79

(Term of Loan: 6 months; maximum number of payments: 6

This loan is secured by a "bill of sale to secure debt" executed by the borrower on the date of the loan covering the following described properties (description of collateral:

(a) Automobile: Make	Model	Year	Manufacturer's Identification Number
DODGE	CHARGER	1968	XP29F8B2990063

(b) Household Goods:
1- G.E. T.V. SET CONSOLE

5. Charges for Late Payments. Lender may collect from the borrower a late charge of 5¢ for each one dollar of any installment which is not paid within five days from the due date (provided that this late charge may be collected only once for each installment), plus interest on the amount of the contract remaining unpaid after the final maturity date at the rate of eight per cent (8%) per annum, plus attorney's fees representing fifteen per cent (15%) of the amount collected if collected by and through an attorney. Failure to pay any installment promptly when due shall, at the option of the lender with or without notice, render all installments, less any unearned interest, unearned maintenance charges, and unearned insurance premiums, immediately due and payable. Upon acceleration, earned interest will be computed on a pro-rata basis by dividing the total interest charge (line 2 (a) above) by the number of months in the term of the loan, the resulting quotient being the amount of earned interest for a one month period. This quotient will then be multiplied by the number of months elapsed between the date of the loan and the date of acceleration, the product representing earned interest at the time of acceleration. Unearned insurance premiums will be refunded by the "Rule of 78's" method (provided borrower makes timely written request for cancellation of said insurance). Explanation of Maintenance Charge: The "maintenance charge" consists of a $2.00 amount which is charged for each full 30 day period the loan remains outstanding during the "term of loan." The failure to pay that part of an "installment" consisting of "maintenance charges" will not render all installments due and payable, and will not be a basis for charging the "5¢" late fee. Maintenance charges will not be included when computing the referenced "fifteen percent" attorney's fees, or the referenced "eight percent (8%) per annum" charged after maturity.

6. Rebate of Finance Charge upon Prepayment of Loan: If the contract is paid in full by cash, a new loan or refinancing before the final installment date, the borrower shall receive a rebate of the unearned portion of the interest and the unearned portion of life, accident and health insurance premiums (Provided the borrower makes timely written request for cancellation of said insurance when the loan is being prepaid in cash). This interest and insurance rebate will be computed by the "Rule of 78's" method. That part of the finance charge which consists of loan fees will be rebated upon prepayment of loans to the extent necessary to assure that no rate (when considering both interest and loan fees) greater than five per cent (5%) per month will be paid by the borrower. No interest refund will be made where the amount of such refund would be less than $1.00. In the event of discharge, refinancing, prepayment of acceleration, "maintenance charges" will be collectible only for the number of full 30 day periods between the date of the loan and the date of such discharge, refinancing, prepayment or acceleration.

The Undersigned Acknowledges Receipt of a Copy of the Disclosure Statement

Borrower:

7. Insurance Disclosure:

(a) Insurance covering loss of or damage to property in which the creditor has been given a security interest is required.

(b) Credit life and credit accident and health insurance is required.

(c) The borrower has the option of providing the insurance required in Subsection "7a" and "7b" above through an existing policy or a policy independently obtained and paid for by the borrower.

(d) The borrower has the right to choose either level term life or reducing term life insurance.

(e) If purchased through the lender, the Type, Term and Cost of Insurance available will be as follows:

(1) Level term life insurance for the term (length) of the loan: Initial amount: $ 132.00 premium: $ 1.12
I desire to purchase this insurance from Lender
Date 09 25 78 Signature

(2) Accident and Health Insurance for the term (length) of the loan, commencing on the fourth day after the loan is executed:
monthly benefit: $ 22.00 premium: $ 6.73
I desire to purchase this insurance from Lender
Date 09 25 78 Signature

(3) Decreasing term life insurance for the term (length) of the loan: initial amount: $ NONE premium: $ NONE
I desire to purchase this insurance from Lender
Date NONE Signature NONE

(4) Single interest property insurance on pledged automobiles for months
Initial amount: $ NONE premium: $ NONE
I desire to purchase this insurance from Lender
Date NONE Signature NONE

(5) Level term property insurance on pledged household goods for the term (length) of the loan amount $ 132.00 premium $ 1.32 I desire to purchase this insurance from Lender

UNION HOME LOANS 4527 North 16th Street, Suite No. 101, Phoenix, Arizona 85016

LOAN STATEMENT MADE IN COMPLIANCE WITH FEDERAL LAW

Loan secured by Trust Deed on 9511 East 33rd Street, Tucson, Arizona 85710

The name of the lender is not at this time known. Upon ascertaining same, it will be furnished to you.

Arranged by Union Home Loans Designated by Federal Law as creditor.

FINANCE CHARGE, accruing from date of deposit of Loan funds in escrow:

A. AMOUNT FINANCED:

1.	Appraisal fees	$ -0-
2.	Credit investigation fees	$ -0-
3.	Notary	$ -0-
4.	Recording fees	$ 6.00
5.	Costs of guaranteeing or investigating Title	$ 45.00
6.	Tax service for period of loan	$ -0-
7.	Fire insurance premiums	$ -0-
8.	Due on prior liens, including reconveyance, etc. Az. Trust	$ 780.00
9.	Due other creditors WLS #950146	$ 120.00
10.	Assumption, transfers, forwarding and beneficiary statement fees	$ -0-
11.	Accident & Health and/or Credit Life Insurance ☐ A & H Payment Ins. $ ____ No. Months ____ Premium $ -0- ☐ Life Amount Ins. $ 1,839.52 No. Months 25 Premium $ 36.59 Total	$ 36.59
12.	Other payments on order of borrower	$ -0-
13.		$ -0-
14.	Estimated to borrower	$ 170.41

AMOUNT FINANCED: (Items 1 — 14 incl.) $ 1,158.00

B. FINANCE CHARGE:

14. The total of the bonuses, brokerage, or commissions contracted for or to be recieved by any person for negotiating, procuring or arranging or making such a loan. (Prepaid **FINANCE CHARGE.**) Earned in full for services rendered $ 300.00

Broker to absorb (-0-) $ 300.00

15.(a) Escrow

A.	Basic escrow fee	$ 42.00
B.	Drawing payoffs	$ -0-
C.	Verifying prior encumbrances	$ -0-
D.	Handling demands and payoffs	$ -0-
E.	Drawing documents	$ -0-

TOTAL ESCROW FEE $ 42.00

LOAN TOTAL (Items 1 — 15a)

This is principal of note $ 1,500.00

16. Interest for period of Loan $ 339.52

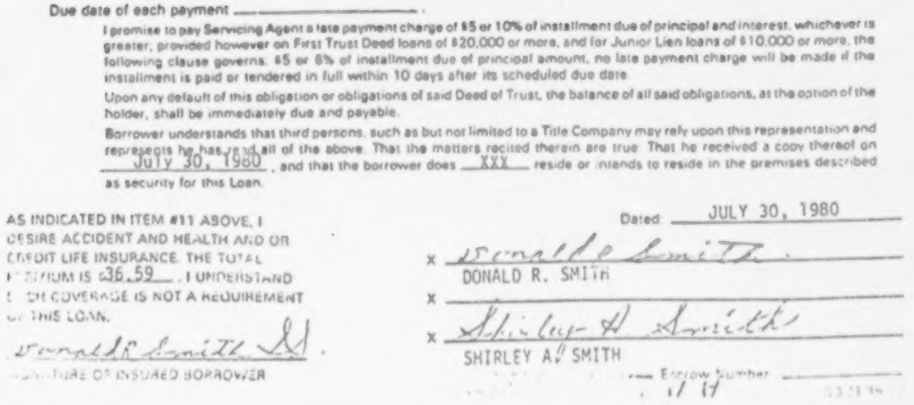
Privilege is reserved, on any installment due date, to pay in full all of the above recited obligations by paying a prepayment consideration equal to 12 months' advance interest of said unpaid obligations, or the maximum permitted by law, EXCEPT if the security for said obligations is a single family, owner-occupied dwelling, privilege is reserved to prepay in whole or in part at any time provided an amount not exceeding 20% of the unpaid balance may be prepaid in any 12 month period and I promise to pay a prepayment charge on any amount prepaid in any 12 month period in excess of 20% of the unpaid balance of 6 months' advance interest in the amount prepaid on said excess. Interest accrues from date lenders' funds are deposited in escrow and the first payment on the note is generally due within thirty days after the close of escrow.

FINANCE CHARGE (Line 15 to Line 16) $ 681.52

C. ANNUAL PERCENTAGE RATE: $ 35.58%

D. LOAN TERMS:

Rate of interest 15 % per year on unpaid balance. Installments: Number 25 Amount: 24 @ $ 50.00 plus balloon payment of $ 639.52 Total of payments 1,839.52



Due date of each payment ________________.

I promise to pay Servicing Agent a late payment charge of $5 or 10% of installment due of principal and interest, whichever is greater, provided however on First Trust Deed loans of $20,000 or more, and for Junior Lien loans of $10,000 or more, the following clause governs: $5 or 8% of installment due of principal amount, no late payment charge will be made if the installment is paid or tendered in full within 10 days after its scheduled due date.

Upon any default of this obligation or obligations of said Deed of Trust, the balance of all said obligations, at the option of the holder, shall be immediately due and payable.

Borrower understands that third persons, such as but not limited to a Title Company may rely upon this representation and represents he has read all of the above. That the matters recited therein are true. That he received a copy thereof on July 30, 1980, and that the borrower does XXX reside or intends to reside in the premises described as security for this Loan.

AS INDICATED IN ITEM #11 ABOVE, I DESIRE ACCIDENT AND HEALTH AND OR CREDIT LIFE INSURANCE. THE TOTAL PREMIUM IS $36.59. I UNDERSTAND SUCH COVERAGE IS NOT A REQUIREMENT OF THIS LOAN.

Donald R. Smith Sr.

SIGNATURE OF INSURED BORROWER

Dated JULY 30, 1980

x Donald R. Smith

DONALD R. SMITH

x

x Shirley A. Smith

SHIRLEY A. SMITH

Escrow Number

STATE OVERRIDE PERIOD

Ms. **Broadman**. Also, let me just interject something about the State override. You are allowing State override for 3 years. One of the concerns that I have with something like that is several States now are experimenting with no usury ceilings. If in 5 years they discover that there are serious abuses and they decide they want to reinstate the usury ceilings, under your bill they could not do that.

Senator **Proxmire**. So, you would extend that?

Ms. **Broadman**. Indefinitely. So, if a State ever wants to override, it should be able to do so.

Senator **Proxmire**. If this legislation does move forward, do you think it should provide for indexed rate ceilings rather than not at all?

Ms. **Broadman**. If you decide to adopt the Federal usury limit, I do think it should be indexed.

Senator **Proxmire**. Is there anything in this bill that would prevent States from insisting on plain English in their contracts?

You make a good point that the consumer is easily confused by using all kinds of complex commercial terms or legal terms, but why can't the State remedy that? Why would this law prohibit the State from taking action?

Ms. **Broadman**. The State could do that. The point that I was making, though, is that if you are going to abolish all State usury ceilings and open up the market, the unsophisticated, to possibly unfair credit charges, the least you should do is require that those contracts be written in language people can understand.

Senator **Proxmire**. Well, the State can do that.

Ms. **Broadman**. The States could do that, but I think you have a responsibility, since you are erasing a body of important consumer protection laws, to try and give consumers the tools to protect themselves against the possible abuses that are created.

Senator **Proxmire**. As the chairman said, why can't we do that through Truth-in-Lending?

Ms. **Broadman**. Truth-in-Lending just requires the disclosure of key contract terms. It does not require at all that the main terms of the contract, or any part of it, be written in plain English that people can understand.

It is a very different statute than the statute we are proposing.

Senator PROXMIRE. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Let me try once again on the 3-year override period. Any State can reassert jurisdiction during that 3-year period, but they do not have to establish particular ceilings.

Down the line then they can establish ceilings, if they have found abuses. They have a 3-year period to say that we want to reassert our jurisdiction. That does not mean they have to be specific during the 3-year period of time.

I am also puzzled with both Mr. Nishimura and you. I am normally the one who is the States' rights advocate. Very rarely have I heard a consumer group testify so strongly in favor—"don't touch those States."

I wish we could have the same viewpoint on many other things. But your normal positions on these things are that the Federal Government should tell the States to do most everything, that they are not competent, capable, responsible, and we must run to Congress to demand those things be done.

Is there a double standard here with both your organizations having such such a strong "don't preempt the States" position? That is about the first time I have heard that in 8 years.

Ms. BROADMAN. I would like to address both points.

The first point is that the States who feel there are no abuses may not reassert their right in this area for the next 3 years.

I don't see any reason why you should be precluding them at some future date—5 years or 4 years—to decide they do want to reassert that right and they do want to protect the people in their States from unconscionable loan sharking.

The second point is, we have always taken the position that good State consumer protection laws should not be preempted. You will note that with a lot of the consumer credit statutes—what you have done is create a Federal standard but you have allowed more protective State laws to remain intact; for example, in the Electronics Funds Transfer Act—and we have supported that.

So there is not a dual standard.

The CHAIRMAN. Do you really think that loan sharking would be prevented by any law that we pass?

As I was discussing earlier, when you weren't here, consider the back room operator who is outside the sphere of legitimate businesses. Do you really think that anything we do with the usury ceilings will prevent that back room operator?

The point I make is that when you have an unreasonable usury ceiling during a period of high interest rates you force the poor and unsophisticated to go around the back of the warehouse and to the guy with his pocket full of money on the street. That kind of loan sharking does exist.

I don't think you can prevent that, but I think usury ceilings can make it worse.

Mr. NISHIMURA. Senator, it is one thing to try to prevent it, and it is another thing to make it legal. But I think loan sharking will always exist to some degree.

The CHAIRMAN. Let's be realistic. We are not talking about licensing somebody who operates out of a warehouse. We're talking about a legitimate business chartered under the banking laws of the State and the finance companies that are subject to investigations, audits, and all of that sort of thing.

We are talking about two different things. The loan sharking of the kind that goes on out the back door, is not legal under any circumstances, under any State or under any Federal law.

Now, a lot of the people you are talking about are incredibly abused by that. So, if you have an arbitrary usury ceiling that denies them credit from legitimate licensed lenders, you are forcing more of those people to go to that guy on the street.

You know what I am talking about—the traditional view of a loan shark—it isn't the local savings and loan across the street that has a big sign and advertises its rates and has to comply with all the laws of the State, Truth-in-Lending, truth in leasing, fair credit reporting, equal credit opportunity, and all of those other protections that exist and should exist.

Mr. NISHIMURA. Mr. Chairman, what my comment was, is that loan sharking will exist no matter what laws you passed. There are some groups of borrowers that would never qualify for credit no matter how high the interest rates. No law is going to wipe out loan-sharking activities.

The second point that I would like to make relates to the New York study. In New York the rates shot up from 18 percent to 25 percent. And from the study by their own banking department there, there was virtually no liberalization of credit standards, which leads us to ask the question, well, how many high-risk people are going to be getting money at 35 percent, how many at 40, how many at 100?

The information is not there for us to answer that question.

Going back to your initial question about States' rights, I think in terms of S. 730, if it makes sense to have a provision to opt out of it, I think it makes sense to have a provision to opt into it. We suggest that S. 730 seek to pass a law that allows States to opts into the Federal preemption rather than opt out.

In terms of whether or not CFA has supported States' rights before, yes, we have, and I believe the standards that we use were described by Ms. Broadman.

The CHAIRMAN. From a very practical standpoint, you probably don't need to worry about it too much. Frank Annunzio is still alive and well in the House of Representatives, and whatever he is likely to do I am sure he will do. So, whatever we do here in the Senate, when you can't even get a simple 1-year extension of the agricultural and business credit provisions as sophisticated as those borrowers are, to be honest and realistic, as I always try to be, Frank is alive and well. [Laughter.]

But we do very much appreciate, very sincerely, your willingness to come and testify before us today. Thank you for your testimony.

The committee is adjourned.

[Whereupon, at 12:05 p.m., the committee was recessed, to reconvene at 2:30 p.m., this same day.]

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

Gentlemen, we appreciate your being here this afternoon to testify.

We had a long number of witnesses at this morning's session. It is rare that we have an afternoon session, but necessary because of the number of witnesses we had on this particular subject.

We are happy to have you with us. Mr. Dixon, if you would like to begin, please.

STATEMENTS OF BILL W. DIXON, FIRST VICE PRESIDENT, FIRST WISCONSIN MILWAUKEE BANK, MILWAUKEE, WIS., ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION; BRUCE McNEILL, PRESIDENT, SUPERIOR FEDERAL SAVINGS AND LOAN, FORT SMITH, ARK., ON BEHALF OF THE U.S. LEAGUE OF SAVINGS ASSOCIATIONS; JAMES BARR, EXECUTIVE VICE PRESIDENT, CREDIT UNION NATIONAL ASSOCIATION; LESLIE R. BUTLER, EXECUTIVE VICE PRESIDENT, FIRST PENNSYLVANIA BANK, N.A., BALA CYNWYD, PA., ON BEHALF OF CONSUMER BANKERS ASSOCIATION; AND ROBERT B. EVANS, PRESIDENT, AMERICAN FINANCIAL SERVICES ASSOCIATION, WASHINGTON, D.C.

Mr. DIXON. Thank you, Mr. Chairman. I'm Bill Dixon, first vice president of the First Wisconsin National Bank in Milwaukee, Wis.

Today, as a representative of the American Bankers Association, I have a very brief written statement I would like to read and then be available to answer questions.

I currently serve on the executive committee of the Association's Bank Card Division. Bank cards are my business.

Our membership consists of over 90 percent of the approximately 14,500 full-service banks in the country, including many, many small banks. We thank you very much for the opportunity to appear and present our views on S. 730.

Not surprisingly, we are appearing in favor of S. 730. Much of the testimony this morning covered some of the points I am going to try to make, so I won't repeat those this afternoon.

We had hoped originally that this type of legislation would have been part of the Garn-St Germain bill in the last session of Congress but it was not part of the final package.

As you know, the original 1980 Depository Deregulation and Monetary Control Act did eliminate State restrictions on interest rates on first mortgage loans and it has also provided a recently expired 3-year limited override on State limits on business and agricultural loan interest rates, which the chairman referred to this morning.

When our cost of funds soared in 1980 and 1981, it was possible to continue to make financing available for housing, farming, and small business, although at higher rates because of the 1980 act which deregulated State limits.

We could, therefore, negotiate loan rates reflecting our cost of money. That was very important in the 1980-81 period. That would not have been possible if we had been locked into artificially low State usury ceilings.

Consumer credit, on the other hand, during those periods—the volume of consumer credit decreased dramatically, primarily because banks and other lenders looked elsewhere for investments because they were locked into, again, archaic State usury limits.

At least in the Midwest we have not heard any horror stories about unconscionable rates being charged during this period in the housing market. The allusion this morning to unreasonably high rates on second mortgage loans has not been characteristic of our experience.

As you know, the liability side of our balance sheet is rapidly being deregulated, and common business sense dictates that the asset side should receive the same treatment. In our business we need a reasonable spread between our cost of funds and interest income.

From a political standpoint, it makes sense to us to pass complete Federal preemption during the current period of lower interest rates, since passage really isn't going to have much of an impact on business or consumers or agriculture during this current interest environment.

Finally, passage would be consistent with the ultimate goal of complete deregulation of the financial industries. We commend the efforts of this committee in providing this forum, and thank you for the opportunity to make our views known again.

[The complete statement follows:]

PREPARED STATEMENT OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the committee, my name is Bill W. Dixon and I am First Vice President of First Wisconsin of Milwaukee Bank, in Milwaukee, Wisconsin. I appear today representing the American Bankers Association. I currently serve on the Executive Committee of the Association's Bank Card Division. Our membership consists of over 90 percent of the approximately 14,500 full service banks in this country, including over 12,000 community banks with deposits of $100 million or less.

Our Association welcomes the opportunity to present our views on S. 730, the Credit Deregulation and Availability Act of 1983. This legislation would eliminate the patchwork of state law and regulation which, in many cases, operates as a barrier to the normal flow of interstate commerce, by federally overriding all existing state usury restrictions.

Approximately two years ago we testified before this Committee on a bill very similar to S. 730. That bill, S. 1406, eventually was included as Title 6 of S. 1720, of which was the genesis of the Garn-St Germain Act of 1982.

It is unfortunate that Title 6 ended up on the cutting room floor last Congress. Our Association has always strongly supported elimination of usury ceilings, since they serve no useful purpose and tend to harm those for whose benefit they are allegedly implemented. We also feel that it is appropriate that deregulation of the asset side of bankings balance sheet be undertaken at the federal level.

While the federal government has taken an active role in impacting the liability side of the ledger, it has, with the exception of limited actions in the 96th Congress, left the regulation of the asset side of the ledger up to the individual states.

Recent developments in the marketplace highlight the need for action at the federal level. More and more, customers are demanding a market rate of return on their deposits. The creation of new depository instruments which yield such a return increases in the cost of funds which can be lent. This, coupled with the upward pressure on costs to depository institutions brought about by the phase-out of Regulation Q, increases in the cost of federal funds and the added strain resulting from reserve requirements, increases the need for financial institutions to be able to charge a market rate on their loans.

Our Association has a longstanding position supporting the removal of all artificial constraints on the ability of the competitive marketplace to determine the price of credit.

BACKGROUND

A brief historical review will, I think, put our position in perspective. The 1980 Depository Institutions Deregulation and Monetary Control Act, began the federal deregulation of both the asset and liability side of banking's balance sheet. The Act contained a total override of all state restrictions on interest rates, discount points or finance charges that affected first mortgages on real estate and manufactured housing. It additionally extended to state chartered, federally insured, banks the minimum lending rate formerly enjoyed only by national banks, of one percent over the discount rate. It also provided a recently expired three year limited override of state limits on business and agricultural loan rates.

On the liability side, the Act provided for a six year phase-out of federal restrictions on the amount of interest depository institutions could pay on their deposits. This job was to be accomplished by the Depository Institutions Deregulation Committee (DIDC), which was established by the Act. The Act also authorized negotiable order of withdrawal accounts or NOW accounts, with which we are all now familiar. This had the effect of converting a large number of formerly noninterest bearing demand deposits into essentially interest bearing checking accounts. The Act also provided for a permanent override of all state restrictions on the rate of interest depository institutions could pay on their deposits, so that the only remaining restraints were federally imposed.

Since 1980, DIDC has made great strides toward the goal of total deregulation of interest on deposits. Currently all time deposits of over 3½ years maturity are totally deregulated and any rate of interest may be paid. IRA and Keogh account interest rates have been deregulated and institutions are free to pay market rates on them. In addition, the DIDC has created shorter maturity, large denomination accounts the rates on which are free to adjust to market pressures.

This whole deregulation process was greatly accelerated by the Garn-St Germain Depository Institutions Deregulation Act of 1982. The most important aspect of this legislation was its directive to DIDC to authorize a new money market account "directly equivalent to and competitive with" the money market mutual funds. This account became available on December 14, 1982. For the first time ever, the average consumer or small businessman with a minimum deposit of $2,500, can receive market rates of interest on a readily assessable, federally insured account.

Noticeably absent from the 1982 Act, however, was any provision to futher deregulate the asset side of the bank ledger. A whole new portion of bankings' liability portfolio is now costing market rates of interest (as of March 9, 1983 there was approximately $200 billion in commerical bank money market deposit and super NOW accounts), without any concurrent relief on the asset side to help finance these new costs. We recognize, Mr. Chairman, your efforts in 1982 to legislate the equitable balance which was contained in the original version of S.1720. As we mentioned earlier, Title 6 of that bill would have provided the fiscal balance which S. 730 again seeks to provide.

The 1980 and 1982 Acts have made major changes in the structure and cost of banking's liability portfolio. The new money market accounts have made the rate paid on deposits very sensitive to market pressures. Banks operate on "spread", the difference between what they pay out on deposits and what they take in on loans. In order to properly manage a bank, the "loan" side of the ledger which funds the payment on deposits, should be equally as sensitive to market pressure. This cannot be the case when restrictive usury ceilings inhibit the appropriate business to market forces.

State usury ceilings governing the amount that creditors can charge on the money they lend are often the product of inefficent and outmoded concepts of so-called "consumer protection". Given today's increasingly dynamic money market, creditors are no longer able to assure the reasonable availability of funds for consumers when restrained by artificial rate ceilings. Due to the growing divergence between state usury ceilings and current economic realities, action must be taken to assure the reasonable expectation of credit availability held by an ever larger number of Americans.

The fallacy of usury ceilings

The rationale for establishing and maintaining usury ceilings has historically been based primarily on the socio-economic intention of preventing lenders from charging exorbitant rates for credit. They have, traditionally, been aimed primarily at the consumer lender, it being generally felt that business or commercial borrowers are active participants in the marketplace and have sufficient business ability to make more informed financing decisions.

This argument has always ignored the most important aspect of the system which will prevent such a result—competition among lenders—and its current use ignores the cadre of consumer legislation enacted over the past decade which insures that the consumer is adequately informed and equitably treated. That market forces truly do serve to determine the price and availability of credit can be shown by "real life" experience.

Over 20 percent of the states have totally eliminated usury ceilings. Not one state that has eliminated ceilings has reimposed them. In fact, a referendum to reinstate a lower usury ceiling in the state of Washington failed by over a 2 to 1 margin in November of last year. Clearly, the competitive marketplace, as advertised, is working in those states where it is allowed to set an appropriate price for credit. If anyone were being overcharged or if credit prices rose to be out of line with neighboring states, legislatures would have been forced to reimpose interest rate ceilings. In fact, however, the marketplace functions better than legislated ceilings could ever hope to work, as evidenced by a recent study by the New York State Banking Commission.

In 1980 the New York State legislature passed legislation which eliminates essentially all currently operative interest rate ceilings in New York. The legislation mandates an annual report from the Banking Commissioner to assess the effect of the statute. The first report issued in early 1981 found that interest rates had risen since the passage of the bill, which was no real surprise since prior rates were unrealistically low. More importantly, however, it found that there was an increase in available consumer credit for New Yorkers. Banks were offering a wide range of rates and fees which provided consumers a broad market within which to shop for credit.

The survey was conducted again in late 1982. Responses were received from over 450 credit extenders including commercial banks, savings and loans, finance companies, retail stores, and automobile dealers. The report issued in December of 1982 made the following major findings:

There was a greater degree of competition among banking institutions for consumer lending.

There was a wide variation on the rates charged by different institutions in the same market area for the same type of loans. Rates range from 14½ to 20 percent depending upon the type and maturity of the loan.

As market rates have fluctuated so too have the rates charged on consumer loans.

Creditors generally are using more liberal credit standards for consumer lending and offering larger credit lines. More institutions are participating in consumer loan activity.

It appears, therefore, that the average New Yorker is better off due to deregulation. The range of financing alternatives has been substantially broadened with more credit available at reasonable rates from more sources to a broader spectrum of potential borrowers.

Most of the rate limitations applicable to consumer credit today are the results of laws providing exceptions to the general usury limits of the state. The net result is a hodge-podge of legislation in most states that has little if any relationship to modern commercial and economic realities. A state may have different laws with different limits on loans by commerical banks, industrial banks, consumer finance companies, and credit unions. There may be different laws for new motor vehicle sales, used motor vehicle sales, and other sales financing. There may be separate limits applicable to mobile home lending and second mortgage loans. Finally, there may be separate statutes for revolving credit plans and bank overdraft checking credit lines.

The recent wide fluctations in interest rates result from attempts by the federal government to bring under control the rampant inflation which has done so much harm to our nation's economy. While individual states have little impact on factors associated with rising costs, actions by the federal government have a direct relationship both to the cause and the cure.

In addition, it should be noted that individual states have *no* impact on the factors associated with the cost of a financial institution's management of its liabilities (e.g., deposits). It is the federal government which has intervened to regulate the liability side of the ledger. We expect that the federal government will continue to play a major role in regulating the availability of money and its corresponding costs, in its attempt to control inflation. For the most part, this task has been assigned to the Federal Reserve which is charged with the conduct of monetary policy. Congress too, however, continues to play a vital role in its attempt to work in concert with the Federal Reserve. Congressional initiatives such as the phasing out of Regulation Q and the imposition of universal reserve requirements, which financial institutions must maintain on certain deposits, have a major impact on the costs associated with a depository institution's management of its liabilities. These factors, when coupled with the effect of competition among financial intermediaries for deposits, amplify the need for federal intervention to deregulate the asset side of the ledger (e.g., loans).

Studies show the negative impact of usury ceilings

Numerous studies have been done to test the effectiveness of usury ceilings. The vast majority of these studies have come to the similar conclusion that usury laws, while well intended, often produce unintended and detrimental effects on consumers, lenders, markets and the economy. Empirical evidence consistently supports competitive market pricing as being clealy superior to legislatively imposed usury ceilings.

In addition to the research done by the private sector, the federal government has examined usury and its effects. The Report of the National Commission on Consumer Finance submitted to Congress in December of 1972 examined the popular theories supporting rate ceilings as necessary for consumer protection and concluded that they did not stand up under scrutiny. The Report concluded that rate ceilings are undesirable.

More recently, the Report of the Interagency Task Force on Thrift Institutions, submitted to Congress in July of 1980, concluded that rate ceilings were a disincentive to thrift institutions' entrance into consumer lending as authorized by the Depository Institutions Deregulation and Monetary Control Act of 1980 and that the ceilings should be removed or set at higher levels. Other studies indicate that, beyond lacking a consumer protection rationale, rate ceilings are harmful to the very individuals and businesses they are designed to protect.

Empirical evidence shows that usury ceilings have the following generally detrimental effects on consumers:

Rate ceilings cause lenders to ration credit by lending to only the lowest risk customers, and by denying loans to less creditworthy consumers. However, because there are variations in the relative creditworthiness of consumers, people should pay different rates based on variations in costs to service them. Logically, better (lower) credit risk borrowers should pay less interest than greater credit risk borrowers. The fact is that lenders tend to accept greater risks as usury rate ceilings increase, and they are more willing to make loans available to a broader segment of the market. On the other hand, usury ceilings that ignore market costs, cause lenders to reduce credit availability to borrowers who have the greatest need. Low rate ceilings force creditors to raise the level of credit scores required to obtain a loan, thereby penalizing both creditworthy and higher risk consumers. However, the heaviest impact of such credit rationing falls on lower-income consumers.

Prices of goods and services are higher in states with restrictive lending rate ceilings than in surrounding states with more liberal rate structures. For example, a 10 percent usury limit in Arkansas effectively dried up the availability of credit and raised the cost of retail products so that residents were forced to shop for automobiles, appliances, furniture and other goods in contiguous states having more liberal rate ceilings.

Usury ceilings force some consumers to acquire more costly credit elsewhere (i.e., from illegal lenders at higher rates).

Lenders in low rate states tend to eliminate smaller, short term loans. Therefore, borrowers in these states are often denied access to credit.

Reduced to basics, a lender's rates are determined initially by consideration of four primary factors: cost of funds; loan origination operating, and other administrative costs; risk premium, and the need to earn a profit for shareholders. Beyond these factors, the lenders, rate is set at the lowest level possible in order that borrowers may be attracted from competitive lenders. In effect, supply and demand set the market rates.

As the costs associated with extending credit approach or exceed the usury ceiling, the market is constrained from working freely, and is thus unable to allocate credit in the most efficient manner. As a general rule, when faced with restrictive usury ceilings, lenders will reduce their extensions of credit and move funds that would have otherwise been extended to borrows to better return situations.

Clearly, these options are not in the best interest of the majority of the borrowing public, since many consumers who need credit will be unable to obtain it. The adverse impact of restrictive usury ceilings in greatest on the less sophisticated and less affluent consumers, as well as first time credit seekers, who can least afford being shut out of the credit market. Since the risk premium is generally the greatest for these consumers, they will either be totally shut off from legitimate credit markets when the cost of granting loans approach the usury ceiling, or be able to obtain credit only under much more stringent terms (e.g., higher down payment, shorter maturity) which they can often ill afford.

Clearly, restrictive usury ceilings have an adverse impact on the ability of the market to allocate credit and services.

Not only are those seeking credit disadvantaged by the artificial constraints placed on the pricing of credit, but the provides of goods and services, particularly small businessmen, are also injured since their potential customers can no longer obtain financing.

There is also ample evidence that usury ceilings have detrimental effects on lenders and local economies. Some lenders have been forced out of the credit market altogether, particularly in the area of bank card credit plans. For example:

Recently, a regional bank in the mid-west divested itself of its entire bank card operation of over 175,000 accounts and $40 million in outstandings, due in part to the impact of restrictive usury ceilings.

Prior to 1980, when New York essentially deregulated its lending environment, Citibank moved its entire credit card operation and approximately 2,000 jobs to South Dakota where their ability to charge market rates and annual fees was not restricted by state law.

A similar exodus was recently noted in Maryland when that state maintained a 12 percent limit on credit card interest rates. A number of Maryland banks moved their card operations to Delaware, or sold them to Delaware banks, just across the border, where restrictive state laws were not a factor.

A recent study prepared by the University of Missouri discovered that in Missouri, where there are 22 different usury ceilings applicable to various types of consumer credit, banks lend approximately 20 percent less to consumers than banks in unregulated states.

One of the most recent compliations of data documenting the detrimental nature of usury ceilings is an article in the mid-year 1982 edition of Economic Perspectives published by the Chicago Federal Reserve Bank. The article entitled "The Effects of Usury Ceilings" analyzes serveral recent studies of the effects of usury ceilings and concludes:

Economic research clearly supports the current legislative moves toward deregulation of usury ceilings. The evidence on the impact of usury ceilings shows that they have not achieved their objectives. According to the empirical studies surveyed, usury ceilings have significantly reduced the availability of credit and created hardships for those who were supposed to be protected. Ceilings have encouraged lenders to use such credit rationing devices as higher down payments, shorter maturities, and higher fees for related noncredit services, which increase the effective interest rate. They have curtailed the amount of credit available to lower income and higher risk borrowers, harming primarily those individuals whom the ceilings are intended to benefit. Finally, the lack of uniformity of usury laws across states has distorted credit flows and economic activity, favoring those states and regions which are less regulated. [*"The Effects of Usury Ceilings"*—Donna Vandenbrink, Mid-year 1982 issue *"Economic Perspectives"* pages 44-55, 55) Pub.—Federal Reserve Bank of Chicago.]

The last sentence of that excerpt is most important. It emphasizes the interestate nature of the problem. Congress recognized and reacted to the barriers imposed by Regulation Q, and in 1980 prescribed the framework for its removal. The 1980 Act also provided a permanent override of state laws that limit the amount of interest that can be paid on deposits and accounts. Congress obviously understood the need for pervasive federal action to achieve its goal of deregualted rates on deposits. The same logic applies when analyzing usury ceiling legislation. If all borrowers nationwide are to have equal access to reasonably priced credit, national action is necessary. Interstate creditors—for instance automobile finance companies—who in order to do business in a particular state must charge a low rate for loans, obviously make up for their losses in other states where there are no such restrictions. Farm implement manufacturers in Illinois, where there are no usury limits, suffer the effects of the restrictive limits which exist in Arkansas. Clearly, this is an interstate problem. Borrowers nationwide, pay the price for the states that refuse to recognize the economic futility of usury ceilings. Congress, not the individual states, is charged under our constitution with enacting laws to regulate interstate commerce. If individual states are unwilling or unable to address this problem, then it is the duty of Congress to eliminate these anachronistic barriers to the interstate flow of commerce.

In summary, studies of state usury ceilings have dismantled the consumer protection and economic arguments in support of usury limits. The time has come to eliminate the disruptive effect which usury ceilings have on the economy, and the free interaction of the credit marketplace.

S. 730 would also make an additional reform in the area of bank cards by authorizing annual, monthly or periodic fees and transaction fees. The prohibitions that exist on these fees in many states create an unfair burden on lower-income consumers and contribute significantly to the unprofitability of card programs.

In many states, card issuers are required to give users a "free period" in which to pay all charges incurred without any charge for the convenience involved in this payments mechanism. As a result, many consumers use their cards simply as a convenient payment device—an alternative to cash or check. The card issuer incurs considerable expenses in processing purchases and payments and in extending funds during this period of "free use" but collects no finance or use charge. A study commissioned by the Massachusetts Bankers Association (Credit Card Profitability Study; Peat, Marwick, Mitchel & Co., February 1980), found that 35 percent of all cardholders involved were free users, i.e., their usage was not subject to any credit or usage charge. While this 35 percent figure is significant, even more so is the fact that these same cardholders represent approximately 50 percent of the total dollar outstandings.

Visa, U.S.A. reported in 1981 that these "free users" were subsidized by active card users to the extent of $661 million in 1979 and a subsidy of $835 million in 1980. For the most part, these "free users" tend to be the more affluent cardholders. S. 730 would enable card issuers to insure that those who use their card only as a convenient method of payment would bear a fair share of expenses for their involvement in a payment mechanism.

The adverse impact of restrictive state card fee legislation on industry and consumers is illustrated in a recent study conducted on behalf of the Credit Research Center at Purdue University (Working Paper No. 35—Restrictive Effects of Rate Ceilings on Consumer Choice; The Massachusetts Experience). That study concluded that credit card users who pay in full, thus incurring little or no finance charges, are being subsidized by those cardholders who make extended payments on their accounts. On average, the consumers receiving this subsidy have higher incomes and use their accounts more frequently than those providing the subsidy. S. 730 by authorizing creditors to impose periodic or transaction fees, would enable card issuers to eliminate this subsidy and provide a more equitable fee structure for all credit card users, thus enhancing competitive alternatives.

The probability of bank card operations is also quite sensitive to changes in the cost of funds. During the recent period of high interest rates, Visa, U.S.A., Inc. has released figures showing that the bank card industry had a loss equal to 1.1 percent of average outstandings in the second half of 1979. As a result of the high cost of funds, the Visa system suffered a loss of over $335 million in 1980. During the first quarter of 1981, Visa system-wide losses grew to a record 2.4 percent of average bank card outstandings. These losses are the direct result of the card issuer's inability to earn a rate of return from the "free users" of the cards and the inability to raise rates as the lenders' cost of funds rises.

The Massachusetts Bankers Association, Credit Card Profitability Study, illustrated the unprofitable status of bank card operations of seven banks in that state during 1979. At that time, Massachusetts banks could charge only 12 percent on credit balances over $500 and 18 percent on balances under $500. The study showed that the cost of funds would have to dip to 6.68 percent for card operations to become profitable unless usury laws, or laws prohibiting credit card fees were changed.

Approximately 35 percent of cardholders involved in the study who used their cards paid off the balance within 30 days without paying finance charges. As a result, less than one-half (43 percent) of all cardholders paid the total finance charge. The study also showed that inflationary costs of labor, supplies, and services plus the creditors' inability to increase finance charges contributed to unprofitability.

The study concluded that unless the rate ceilings were raised, the only means of avoiding unprofitable operations was to eliminate unprofitable accounts (i.e., free users) or withdraw from credit card operations. Imposition of fees on use of the card as a payments vehicle would allow the card issuer to realize a fair return on the unprofitable accounts. If consumers demand the ease of payment offered by the credit card payment system, it is only fair that all participants in the system bear the cost of the system.

The reforms proposed by S. 730 will have a positive effect on small business. Elimination of usury ceilings will remove the artificial constraints which make it necessary for creditors to divert funds from consumer lending to other, more profitable investments during periods of high interest rates. This will insure the more constant availability of funds for consumers that is vital to the health and vitality of small businesses.

Recent experience indicates the disastrous effects a period of high interest rates coupled with restrictive state ceilings can have on small businesses.

As interest rates soared, the small merchant felt the crunch first. Sales decreased because the small merchant does not have access to sufficient funds for consumer lending during a period of tight credit. A large retailer operating its own credit program can better afford to absorb losses on credit operations because of potential profits on sales. Many businesses do not have this luxury, and must rely on credit extended by third parties. Our experience with deregulated rates has also shown that the marketplace is an efficient and equitable allocator of credit, if allowed to operate.

The authorization of card fees will also help small businesses which rely heavily on independent credit programs such as bank cards. By accepting a bank card or a number of different cards, the small merchant is able to avoid a costly, inefficient, in-house credit program while, at the same time, enjoying the benefits of increased sales that result from the convenience of credit. Card fees would help to insure the vitality of these essential programs.

In conclusion, we emphasize the pressing need for the reforms contained in S. 730. The long term economic health of the consumer credit industry is dependent on these reforms.

We appreciate this opportunity to discuss these issues and make our views known. I would be happy to try and answer any questions any of you might have.

The CHAIRMAN. Mr. McNeill.

BRUCE McNEILL, PRESIDENT, SUPERIOR FEDERAL SAVINGS & LOAN, FORT SMITH, ARK., ON BEHALF OF THE U.S. LEAGUE OF SAVINGS ASSOCIATIONS

Mr. McNEILL. Mr. Chairman, my name is Bruce McNeill. I am President of Superior Federal Savings & Loan Association of Ft. Smith, Arkansas.

Today I appear on behalf of the U.S. League of Savings Institutions and the 3,800-member savings and loan associations and savings bank members of the league.

Due to the lateness of the hour and the limited time available for an oral statement today, I won't try to rehash the written statement that the committee already has. Rather, I would like to take just a few minutes to discuss some personal experiences that I have had in Arkansas with the lack of availability of credit.

My hometown of Ft. Smith is on the western border of the States of Arkansas and Oklahoma. From that unique vantage point I have had the opportunity to see what, until last November, was the most restrictive usury provision in the United States, hamper the availability of credit in Arkansas. Across the State line in Oklahoma I had the opportunity to see Tulsa and Oklahoma City and Muskogee grow and prosper, where our capital and our State suffered greatly.

I think in the deregulated financial environment that we operate in today we must all recognize that money, or at least the return on money, like water, is going to seek its own level. If it cannot be profitably invested in this community, it will go to another, or to another State.

I can recall one instance where an acquaintance of mine came to me, in probably late 1979, prior to the Federal preemption of our Arkansas usury statute. This gentleman was a distributor of X-ray equipment. He told me that for 5 years he had been attempting to secure this additional line of equipment. The manufacturer required that he expand his facility, upgrade his warehouse, et cetera, and he wanted to borrow the money.

Unfortunately, we were unable to loan him the money because of Arkansas' 10 percent usury level. And he said:

> Bruce, I can afford to pay the higher rate. I need this line of equipment in my business. I need the depreciation for my tax shelter, and that is a business decision that I would like to make.

I could only respond, "Bob, I am sorry. The drafters of our 104-year-old Constitution made that decision for you many years ago."

Subsequently, this man moved his operation to Tulsa. Had his operation been in Oklahoma, we would have been delighted to extend a line of credit, but it was not.

In view of this, we have a State that—in many instances—has almost dried up the availability of credit. Obviously, J.C. Penney, Sears, GMAC, and Ford Motor Credit for many years subsidized Arkansas borrowers because of the 10 percent limit.

But I think that, as I mentioned earlier, with the era of the deregulated financial institution is now upon us, that opportunity to borrow at below market rates is long gone.

Senator, I would like to commend you, Senator Proxmire and Senator Lugar, for moving forward with this legislation. I am sure there are those who say that there is no need for this type of legislation in a declining rate environment, but I am of the other opinion—that this gives us an opportunity for the Congress, in a reasoned, thoughtful manner, to debate and to pass legislation such as this without us having to come to you in a high-rate environment with an impassioned plea to do something quickly.

I thank you for the opportunity to appear before this distinguished committee and I look forward to questions.

[The complete statement follows:]

PREPARED STATEMENT OF BRUCE MCNEILL, PRESIDENT, SUPERIOR FEDERAL SAVINGS AND LOAN ASSOCIATION, FORT SMITH, ARK.

Thank you Mr. Chairman, and members of this distinguished Committee for the opportunity to appear before you today in support of S. [illegible], the Credit Deregulation and Availability Act of 1983. My name is Bruce McNeill, and I am President of Superior Federal Savings and Loan Association of Fort Smith, Arkansas. I am here today as a representative of the U.S. League of Savings Institutions,[1] which I serve as a member of the Legislative Committee.

We in the savings institutions business applaud your foresight, Chairman Garn, and that of your cosponsors—Senator Proxmire and Senator Lugar—for the introduction of this most import piece of legislation. Our organization supported this effort in 1981 when it was initiated by Senator Lugar. If anything, the degree of our support has increased, and increased significantly since that time, due to legislative events that have occurred in the interim.

Most important among these occurrences, of course, was the enactment last October of the Garn-St Germain Depository Institutions Act of 1982 (Public Law 97-320), which, in effect, completed the deregulation of the liability side of our ledgers with its mandate for the new Money Market Deposit Account—a ceiling-free, market-rate, no-term, Transactionable account—and with the introduction of Super NOW accounts.

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[1] The U.S. League of Saving Institutions, formerly the U.S. League of Savings Associations, has a membership of 3,800 companies representing over 99 percent of the assets of the $700 billion savings and loan business. League membership includes all types of associations—Federal and state-chartered, stock and mutual. Many prominent savings banks belong as associate members. The principal officers are: Leonard Shane, Chairman, Huntington Beach, CA; Paul Prior, Vice-Chairman, New Castle, IN; William O'Connell, President, Chicago, IL; Stuart Davis, Legislative Chairman, Beverly Hills, CA; Roy Green, Executive Vice President; Phil Gasteyer, Legislative Counsel; James Freeman, Senior Legislative Representative. League headquarters are at 111 East Wacker Drive, Chicago, IL 60601. The Washington office is located at 1709 New York Avenue, N.W., Washington, D.C. 2006. Telephone (202) 637-8900.

You all are aware, I know, of the disintermediation that traditional depository institutions suffered at the hands of money market mutual funds (MMMFs) prior to the introduction of our own competitive accounts—the Money Market Deposit Accounts and the Super NOW Accounts—in December 1982 and January of this year, respectively. In the three years prior to that (See Table I)—during the period of rampant inflation and high and volatile interest rates—savings institutions reported net outflows of savings deposit dollars on virtually a continuing basis. It was only with the introduction of the money market fund-competitive accounts that this situation was reversed.

The turn-around in deposit flow since the advent of the new accounts has been phenomenal, since our institutions are able now to meet savers' demands for market-rate earnings on their deposits. Not only have deposits come home from the MMMFs to these new accounts, but they have shifted from lower-yielding accounts—passbook accounts, for example—as well. And, fortunately, these developments have occurred during a period of dramatically-declining market interest rates.

In times past, depository institutions—given the current scenario—could look forward with expectation to a period of sustained profitability. With deposit interest ceilings in place, and with knowledge of the historic percentage distribution of deposits in various account categories, a managing officer could predict with some degree of accuracy what his or her money costs would be in the months ahead, and could structure his or her association's investment portfolio accordingly. That is not possible today, given the deregulated marketplace and unpredictable interest rate environment in which we find ourselves. There is no question that—had deposit rate ceilings continued in effect during this most welcome period with declining interest rates—our current cost of money would be lower in comparison with market rates than it is today. But today we are tied firmly to the market in terms of our cost of money. No longer is that cost reduced artificially by mandatory deposit rate ceilings.

It follows, then, that the cost of renting out that same money in the form of consumer, mortgage, agricultural and buiness loans is now bound even more tightly to general market rates. If market rates soar again, the flow of credit could be diminished—if not cut off altogether—if lending institutions are blocked by state-imposed artificial usury ceilings. That happened repreatedly before the Federal preemptions enacted in the Depositiory Institutions Deregulation and Monetary Control Act (Public Law 96-221), which S. 730 is designed to extend and expand.

History has taught us that usury laws deny credit to both the consumer and the business sectors in periods of exceptionally high market interest rates, and the history of which I speak was written well before the effective removal of deposit rate ceilings.

Another important legislative occurrence since this Committee's initial consideration of usury preemption legislation has been the authorization—in the Garn-St Germain Act Depository Institutions Act of 1982—for savings institutions to enter or expand their involvement in consumer, agriculture, commercial and business lending. First-lien mortgage interest rate usury ceilings, of course, were "permanently" preempted by the 1980 Depository Institutions Deregulation and Monetary Control Act (unless reestablished by affirmative State action within three years). But the same "permanent" preemption was not extended to usury ceilings on business, agricultural and consumer credit. (The preemption for business/agricultural lending expired on March 31 of this year, and state consumer usury statutes were not affected by the 1980 Congressional decision.)

The Garn-St Germain Act was designed in part to encourage the diversification of savings institutions portfolios to include these other loan categories. By doing so, this Committee hoped to ensure that savings institutions would be able to develop the flexibility to withstand the battering we took over the past several years when our investments were weighted down with old, long-term, fixed-rate mortgage loans made in lower-rate periods. This diversification is much welcomed by our institutions. But we can not be expected to proceed with portfolio restructuring if we find state usury ceilings which apply to our new lending authorities rendering such loans unprofitable.

Without question, where state usury ceilings apply to business, commercial, consumer and agricultural credit, those state laws are running counter to the intent of this Committee and the 97th Congress, as it was expressed in enactment of the Garn-St Germain Act of 1982.

Before concluding, I have one minor suggestion for the definition of "creditor" appearing in Section 532 of S. 730. It might be helpful, as a matter of clarification, to recite that supervised depository institutions are "creditors" within the meaning of that definition. In many states, supervised financial institutions—because of their frequent examinations by State and Federal officials—are exempted from licensing requirements. The definition now appearing in Section 532(a)(3) could conceivably be misunderstood to exclude from coverage unlicensed, though highly supervised, depository institutions. I am sure that was not the intent of the drafters of S. 730. The matter would be easily rectified by inserting "or depository institution" after the word "person" in the first sentence of Section 532(a)(3); there is no need for defining "depository institution" since that definition appears in Section 501 of Pub. L. 96-221 (the statute being amended by the Consumer Credit Title II).

In conclusion, I would concur with you, Chairman Garn, when you said upon your introduction of S. 730, that "it is time to balance the equation and allow the market to establish the price of credit, just as we have determined to allow the market to govern the rate to be paid for savings." Not to do so would be to invite in futue periods of high interest rates the serious reductions in credit availability that have disrupted our economy so frequently in recent years.

Thank you for this opportunity to offer the views of the U.S. League of Savings Institutions. I welcome your questions.

The CHAIRMAN. Mr. Barr.

JAMES BARR, EXECUTIVE VICE PRESIDENT, CREDIT UNION NATIONAL ASSOCIATION

Mr. BARR. Thank you very much, Mr. Chairman. I apologize for this last second shift in gears.

Our chairman-elect, who was supposed to testify here this afternoon, of the National Association, was requested to attend a meeting at the White House. He is there pinch hitting for our chairman, who is recovering from surgery. So, I am afraid I am going to have to do.

I am Jim Barr, executive vice president of the Credit Union National Association.

It is a pleasure to appear before you once again on behalf of our 52-member leagues and the 20,000 credit unions they represent.

Much of what needs to be said about S. 730 has already been said. There is no real point in my taking your time and the time of others to go through a lengthy prepared statement. But as you well know, credit unions were saddled with a 12 percent interest ceiling for almost 50 years, from 1934 to 1980.

Nobody really paid much attention to the ceilings because credit unions traditionally charged loan rates well under the 12-percent maximum. When interest rates skyrocketed, credit unions were deregulated on the liability side to enable them to compete.

And as they said once in the song, you really can't have one without the other. If you are going to deregulate on the liability side, it seems you have to deregulate on the asset side as well.

I think Chairman Callahan this morning summed up our position very well when he pointed out the terrible condition that credit unions were in in the latter part of the 1970's, when they were burdened with a 12 percent interest rate ceiling while the prime rate at that point had reached in some areas 20 percent and above. It became really a matter of safety and soundness. Then Public Law 96-221 was passed. The ceiling was raised to 15 percent, with the NCUA board given the ability to go above 15 percent, circumstances warranting.

They moved the ceiling to 21 percent and it has remained there for approximately 2 years.

The arguments you heard this morning would indicate that with the 21 percent interest rate ceiling credit unions would immediately go to the maximum. As I have testified before, this did not occur. I have current data as of yearend 1982, in any case, that credit unions are well under the 21 percent.

We support S. 730, Mr. Chairman. We believe it is an idea whose time has not only come but is long overdue, and we compliment you, Senator Proxmire and Senator Lugar and others, for introducing this legislation. We hope it moves out of the Senate and is considered favorably by the House.

Thank you very much.

[The complete statement follows:]

Prepared Statement of Harold T. Welsh, President, General Foods Employees Credit Union, Kankakee, Ill., on Behalf of Credit Union National Association, Inc.

Good day. My name is Harold T. Welsh. I am the President of the General Foods Employees Credit Union, Kankakee, Illinois, and the First Vice Chairman of the Credit Union National Association, Inc. The Credit Union National Association, Inc. (CUNA) represents more than 20,000 of the nation's state and federally chartered credit unions through 52 member credit union leagues. These leagues are located in each of the states, the District of Columbia and Puerto Rico. America's credit unions serve more than 46 million members.

CUNA greatly appreciates this opportunity to comment on the issue of interest rate ceilings in general and state interest rate ceilings on consumer credit transactions in particular. The issues involved are fundamental to the concepts of self-management and democratic control on which credit unions are based. A credit union is organized to provide its members an opportunity to use and control their own money on a democratic basis in order to improve their economic and social condition. As financial cooperatives, each credit union should be free—within the bounds of safety and soundness—to run its own affairs according to the needs of its members.

Each credit union should be able to decide what interest rate to pay its members-savers. And each credit union should be able to decide what loan rates to charge its member-borrowers. "The Credit Deregulation and Availability Act of 1983" (S. 730) would give federal credit unions just such authority, and, therefore, CUNA supports this measure.

The principal legislative and regulatory concern of government should be the safety and soundness of the institutions they charter and supervise. Determining the interest rates that financial institutions may charge borrowers or pay savers should not be a task for government. Rather, CUNA believes that the free market in conjunction with the institutions themselves should dictate interest rates.

CUNA testified before this committee in support of a similar usury relief measure two years ago, but the current bill, S. 730, includes several worthwile additions.

Section 4 of S.730 would give federal credit unions complete freedom to set their loan rates. Since credit unions are no longer limited in the rate they may pay on savings accounts, they should also have the authority to charge appropriate rates of interest on loans. Such flexibility is necessary so that credit unions can recover their operating expenses, set aside the necessary reserves, and pay a market rate for savings. The balancing of these factors can only be made effectively and efficiently at the levels of each individual credit union, not in Washington.

Section 2 of S. 730 would permanently preempt state usury laws covering business and agricultural loans. Under Section 2, there would be no lending rate ceilings on such loans, and the $1,000 minimum would be eliminated.

When Congress passed H.R. 4986 in April of 1980, it took a cautious approach and permitted the federal preemptions on a temporary three-year basis. Now that this approach to alleviating the effect of controls on business and agricultural loans has proved its value—it can be safely done on a permanent basis if states so desire.

Eliminating all rate ceilings and thresholds for those categories of credit is consistent with the policy of deregulation. The rate ceiling established in Title V of

Pub. L. 96-221 for business and agricultural credit above $1,000 was welcome, but the $1,000 threshold was still an artificial control.

This bill continues to recognize the important role played by state law in establishing the competitive framework within each state. Thus states are provided the opportunity to establish their own limits and restrictions on lending, if done so within a three-year period from the date of enactment of this legislation.

Moreover, any state that acted to override the provisions of Pub. L. 96-221, need not, under this legislation, reenact usury legislation. The prior state action to override the federal preemption remains valid under this bill. This is an important addition that protects state authority in this area.

Section 3 of S. 730 would establish a new permanent federal consumer loan usury standard. Currently, state chartered, federally insured credit unions are permitted to charge 1 percent over the discount rate in effect in the Federal Reserve District where the credit union is located or to charge the rate allowed by the laws of the state where such credit union is located (the "most favored lender" doctrine), whichever may be greater. States are authorized to override the federal preemption provision. Federal credit unions were, and still are, subject to a 15 percent federal loan rate ceiling (or such higher rates as approved under certain circumstances by their Federal regulatior, NCUA).

Section 3 of the Credit Deregulation and Availability Act of 1983 also eliminates the 1 percent above the Fed discount rate ceiling that currently is in the statute and makes the use of the most favored lender doctrine unnecessary. Thus all insured credit unions would be subject to market rates. Again, CUNA has long supported this market approach to lending rate legislation.

The states, under Section 3 of S. 730, maintain their rights to reject this federal approach for a period of three years from the date the bill becomes effective.

Section 4 of this bill eliminates the federal usury ceiling which federally chartered credit unions are currently subject to (12 U.S.C. 1757(5)(A)(vi)). Lending rate ceilings could be established by the boards of directors of credit unions.

S. 730 wisely adds transition rules for open-end credit arrangements in the event a state overrides the federal preemption. The transition rules would apply for 18 months after the state acts to override and provides a period for lenders to alter open-end contracts to meet state law.

S. 730 also would permit a state to select what transactions or charges they may wish to override. This approach makes it possible for states to avoid rejecting outright federal preemption of the entire consumer credit category.

HISTORICAL BACKGROUND AND RECENT EXPERIENCE

Federal credit unions have always operated under a usury ceiling. Partly this was because credit unions were founded to provide people of limited means with reasonably priced credit. A usury ceiling reinforced that goal in principle, if not in practice. I say not in practice, because in 1934 when the Federal Credit Union Act was passed, Congress included in it a federal credit union usury ceiling of 12 percent. Since, at the time, the prime rate was 6 percent and credit unions and banks were not allowed by law to pay more than 3 percent on savings accounts, the 12 percent ceiling was, in effect, no ceiling at all.

This situation continued until mid-1978 when the combination of federal ceilings on saving account rates and soaring inflation rewarded the borrower and penalized the saver.

The drive to lift the 12 percent loan rate ceiling was often perceived and portrayed as an assault of credit union principles; in fact, it was just the opposite—a move in defense of those principles. The intent of Congress in 1934 when it enacted the 12 percent ceiling as part of the Federal Credit Union Act was to help persons of average means meet their credit needs at "normal rates"—not subsidized rates—of interest. In the market conditions that prevailed beginning in 1978, and which continue to persist today, a 12 percent loan rate ceiling could no longer be considered "normal". Savers were asking and demanding—legitimately—to be paid higher rates in order to protect their funds from the destructive impact of inflation.

When Congress enacted the Federal Credit Union Act 1934, the country was emerging from a depression. The inflation rate that year was 3.4 percent. Bank rates on short-term loans to the banks' most creditworthy business customers were consistently below 6 percent, rates on money market instruments never rose above 5 percent and savings account rates were limited by Regulation Q to 3 percent or less. Under these economic conditions, the 12 percent ceiling was, in effect, no ceiling at all except as a protection against the 42 percent and higher rates then being charged working people in this country.

The economic conditions of 1978-80 and today are much different than they were in 1934. Short-term business loans and money market rates are consistently at much higher levels, the prime rate having been as high as 20 percent. Interest rates available to savers at depository and non-depository institutions range from 2 to 5 times higher than 1934 savings account interest rates. Loan interest rate ceilings which do not accommodate for these costs and allow for sufficient operating spreads, obviously do injury to credit unions and their members when usury ceilings are near market rates.

The harm comes primarily in two forms. First, as rates demanded by savers squeeze or exceed the loan rate ceiling, credit unions find themselves increasingly unable to generate the earnings required to pay the necessary rates to attract and retain savings. This causes a disintermediation which in turn reduces and, in some cases, dries up, the funds available for lending.

Second, under the economic conditions outlined above, the loan rate ceiling causes discrimination between credit union mumbers; i.e., between members as savers and members as borrowers. For example, over the decade of the 1970's, the 12 percent loan rate had an average after inflation value of minus 1.2 percent. Thus a topsy-turvy world was created in which borrowers were paid to borrow and savers were charged to save.

In short, the 12 percent loan rate ceiling forced a transfer of income from credit union mumbers as savers to credit union members as borrowers. The loan rate ceiling, enacted at other times and for other reasons, was never intended to have this effect. Credit unions are member-owned credit cooperatives. Under cooperative principles, members are to be treated equitably. Underwriting interest rates at a net loss to savers is not equitable. Credit union members are entitled to earn a real rate of return on the savings they make available to other members in the form of credit.

Less obvious, but just as real, is the question of equity involving transfers of benefits from members unable to borrow, because of the effect of the loan rate ceiling, to those members who are able to secure loans. Whenever a credit union, because of liquidity pressures, has to adopt measures that limit loans, a group of disadvantaged borrowers will exist. All types of credit rationing requires rules to determine who will and will not have access to loanable funds. There rules must necessarily include some potential borrowers.

If a credit union allocates loanable funds on the basis of first-come, first-served, the unfortunate members may be those simply unlucky enough to be at the end of the line. If the credit union establishes a minimum loan amount, borrowers requesting smaller amounts will be excluded. If creditworthiness standards are raised, lower-income borrowers tend to be left out. If the credit union raises downpayment requirements and/or lowers loan maturities, lower-income borrowers again tend to be excluded.

Raising loan rates at times of liquidity pressures is, of course, a form of credit rationing. However, price rationing is less likely to work against lower-income borrowers than are typical forms of non-price rationing. Reducing loan demand by rate increases allows each potential borrower the choice of whether or not to seek a loan. Raising loan rates in times of liquidity pressures also tends to provide more loanable funds to borrowers who otherwise would be excluded.

Credit unions abhor high interest rates in general and in particular the high rates required by the current state of the economy. As not-for-profit financial cooperatives, high interest rates hold no profit or benefits for credit unions or their members. However, credit unions recognize that loan rate ceilings, enacted at other times and for other reasons, were never intended to distort the operations of credit unions and to cause discrimination between credit union members.

In April, 1980, Congress took an important step forward by increasing the loan rate ceiling to 15 percent and authorizing the National Credit Union Administration Board to set a temporary higher rate if certain economic conditions are met. As a result, the liquidity position of credit unions was improved substantially and the credit union system attracted a net inflow of savings during a period when its sister institutions in the thrift industry—the savings and loan associations and mutual savings banks—were experiencing record outflows of funds.

We believe the record is clear. Given the opportunity to serve their members' needs, as those needs are determined by the members of each individual credit union, the credit union system can and will compete in the financial marketplace. Therefore, we believe the time is appropriate for Congress to go the full way and allow each credit union, through its members, to decide for itself what to charge for loans and what to pay for savings.

Again, we urge the Congress to seize this opportunity to provide Federal credit unions with the right to decide for themselves what to pay for savings and what to charge for loans. It is a right basic to the whole credit union philosophy. Besides, it is good economic policy.

Be assured that any efforts the Congress takes to better enable credit unions to provide our members better rates of return on their savings by enabling them to determine their own destiny with regard to rate setting will be fully supported by the Credit Union National Association.

Thank you for the opportunity to be here this morning.

The CHAIRMAN. Mr. Butler.

LESLIE R. BUTLER, EXECUTIVE VICE PRESIDENT, FIRST PENNSYLVANIA BANK, N.A., BALA CYNWYD, PA., ON BEHALF OF CONSUMER BANKERS ASSOCIATION

Mr. BUTLER. Thank you, Mr. Chairman. I am Leslie R. Butler, executive vice president of First Pennsylvania Bank of Philadelphia. I am also a past chairman of the board of directors and of the government relations committee of the Consumer Bankers Association, whom I represent today.

As with the other panelists, I would like briefly to highlight the more extensive remarks we have already submitted.

As Secretary Treasurer Donald Regan testified April 6 before the Senate Committee on Banking, Housing, and Urban Affairs, "the removal of usury ceilings would also benefit borrowers by making it easier for them to obtain credit. The administration believes that usury ceilings only distort financial market and credit flows and do not reduce the cost of credit to the economy."

Institutions are more likely to lend to all types of borrowers if loans can be priced to reflect the risk of exposure.

The concerns and problems we have discussed in prior hearings continue. Although the cost of funds has recently decreased, the volatile economic events of the last 4 years have caused financial institutions to reevaluate their internal policies regarding both the extension of credit and the pricing of loan products.

As the Government deficit continues to increase, we cannot assume that interest rates or the cost of funds will stabilize at today's lower levels.

Parenthetically, I might note, I was feeling the need to rise in applause of your comments this morning, but was advised by the staff that that was inappropriate. This afternoon I would like to highlight our views on this important topic and respond to any questions you may raise.

Let me first summarize and comment on the four general arguments which are used to support usury laws.

NO EFFECTIVE COMPETITION IN THE CREDIT INDUSTRY

The first is that there is no effective competition in the credit industry. Competition in the industry can be examined by looking at the experience in States with no usury limits or with very high usury limits.

In California, where banks are not subject to usury limits, there is simply no evidence that creditors are reaping unusually high rates of return. New York has recently extended a temporary and limited lifting of interest rates.

A recent survey of 20 commercial banks in New York showed a wide range of rates for various types of loans. These variations present consumers with many alternative plans that can be identified through credit shopping.

The second argument is the fear that consumers are generally unsophisticated in credit matters and therefore unaware of credit costs.

This reasoning seems to fly in the face of extensive private and Government studies, indicating that the millions of dollars spent by the credit industry on Truth-in-Lending disclosure activity have in fact produced the desired results.

The third argument is that the limitation of the available volume of credit caused by usury limits protects consumers from overextension. This argument has been rebutted by studies showing that the growth of credit is similar to the rate of inflation, and the fact that consumers are not overborrowing has also been shown by private studies, using a variety of income statement and balance sheet approaches.

The fourth argument is that usury laws are necessary to prevent loan sharking. It is frankly difficult to imagine loan sharks are going to be influenced by any form of legal constraints. There is no evidence to indicate that they follow usury laws. On the contrary, usury laws hurt only legitimate credit grantors. The use of these laws to prosecute loan sharks is not needed, since many State and Federal laws provide criminal penalties for such activities.

In summary, Mr. Chairman, the four bases cited for the continuation of usury laws are simply without foundation in today's society.

As in other attempts at placing economic controls on the economy, Government price controls do not produce benefits to the market or to those they serve. In actuality, the usury laws damage both the economy and the very consumers they are said to protect.

We agree with Secretary Regan's previously quoted statement and point to a variety of responses that financial institutions have employed as a result of these laws, including reduced credit availability, elimination of certain types of credit, and extreme caution in pricing decisions.

Mr. Chairman, S. 730 will provide needed relief for both creditors and consumers. We strongly support the provisions that permanently remove all interest rate ceilings. The changes reflected in the bill are totally appropriate, given the desirability of a market-determined operation.

We have two mild concerns one regarding the definition of cover charges, which differs somewhat from last year's legislation, and the other which is the inclusion of the State opt-out provision. Both of these are explained in more detail in our written testimony.

Mr. Chairman, usury relief is essential to our industry. As in other segments of our economy, the imposition of arbitrary price controls is inconsistent with the efficient operation of an open-market economy.

The Consumer Bankers Association respectfully urges favorable action on S. 730.

Thank you.

[The complete statement follows:]

PREPARED STATEMENT OF LESLIE R. BULTER, CONSUMER BANKERS ASSOCIATION

Mr. Chairman, I am Leslie R. Bulter, Executive Vice President of The First Pennsylvania Bank, N.A. and a Past Chairman of the Board of Directors and the Governmental Relations Committee of the Consumer Bankers Association (CBA).[1]

I presently serve as Chairman of the Policy Board of the Journal of Retail Banking, published by the Consumer Bankers Association in cooperation with the MacIntire School of Commerce at the University of Virginia. On behalf of CBA, I appreciate this opportunity to appear before the committee to discuss one of the most critical issues facing the retail banking industry: the continued imposition of arbitrary governmental price controls on a commodity—money—in the form of state and federal usury laws.

Mr. Chairman, as you know, during the past few years the Association has had the opportunity to appear before this Committee several times, and on each occasion we have discussed in detail our concerns about government-imposed rate ceilings. In the past our testimony has analyzed the problems caused by usury; the lack of continued economic justification for usury; the economic and other disruptions that have been caused by these provisions; the very real ways in which usury ceilings adversely affect the very consumers that they are said to protect; and the reasons that a federal response to the problem is not only appropriate but essential. We completely agree with Secretary of the Treasury, Donald T. Regan, who testified before this Committee on April 6, 1983 and that "usury ceilings only distort markets and credit flows and do not reduce the cost of credit to the economy."

We will not attempt this afternoon to repeat all that we have previously shared with the members of this Committee. The concerns and problems that we have discussed in prior hearings continue. Though recently the cost of funds has decreased, the volatile economic events of the past four years have caused financial institutions to re-evaluate their internal policies with respect to extending credit and setting rates on all types of loans. During the last twenty years interest rates remained fairly constant. This was a direct result of the fact that the economy was stable, the money supply was predictable, and Regulation Q assured an inexpensive source of funds. However, the recent inflationary spiral changed the marketplace dramatically. Not only did the cost of money rise substantially, but also the traditional methods of predicting that cost were no longer viable. Financial institutions were faced with the problem of pricing their goods in an era of extraordinary inflation with no reliable mechanism available to help them determine what the economic situation would be like in the future. Today, as the U.S. government deficit continues to increase, we cannot assume that interest rates or the cost of funds will remain at today's lower levels or decrease in the near future. Consumer or retail lending divisions of banks are particularly affected by the dramatic shifts in the economy because consumer loans are generally offered at terms as short as one year to as long as fifteen years. As a result, retail lenders are now more hesitant to extend credit, largely based on anticipated inflationary expectations. Therefore, in order to protect the earnings position of financial institutions, lenders would prefer to match their assets and liabilities by lending long term when they are borrowing long term. However, today's consumer depositors, as well as institutional money managers, are investing their funds in short-term, market-sensitive instruments. Thus, lenders are hesitant to make these longer-term loans at restricted rates. The plight of the thrifts with their mortgage portfolios during the past several years certainly demonstrates this point. As a result, lenders are very sensitive to marketplace restraints such as usury ceilings.

Our comments today will consist of a brief look at the background of usury laws, a discussion of their obsolescence and the reasons supporting a federal response to the usury problem. Finally, Mr. Chairman, we would like to comment specifically on S. 730, legislation now pending before this Committee, introduced by you, Senator Proxmire and Senator Lugar, a bill that we believe provides a realistic and much-needed response to this national problem.

INTRODUCTION

The usury laws of the various states are a reflection of inconsistent notions. In part, they are the current embodiment of the ancient social and religious views that lending is, in itself, distasteful and sinful. As this century's demand for consumer credit matured, these laws reflect an acceptance of special treatment for small loans, retail installment sale agreements and other credit transactions where the economic risk exceeded the return permitted by the traditional usury limit. This long and multifaceted background has resulted in a patchwork of usury laws that have no one central historical justification. When considering arguments often cited in support of the continuation of these artificial government price controls, one must keep in mind the moral implications about usury and lending that developed during vastly different times.

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[1] The Association is a nonprofit organization that was organized in October 1919 to provide a voice for the consumer banking industry. Today the membership of the Association consists of than 500 commercial banks of all sizes that are actively engaged in extending consumer credit. Combined, the members of the Association now hold over 70 percent of all consumer credit outstandings and over 80 percent of total consumer deposits held by commercial banks.

ARGUMENTS FOR THE CONTINUATION OF USURY LAWS

We should consider the contemporary viability of usury ceilings in light of current market, economic and social realities. Upon that review, it becomes apparent that these price controls—if they ever served a purpose—now reflect consumer protection concepts that are outmoded and cannot be supported on either economic or social grounds.

First, it is helpful to analyze the context in which this discussion should take place. Second, I will identify and refute the four principal arguments cited in support of the continuation of usury restrictions.

1. The context

The fundamental starting point in analyzing the justification for usury ceilings is the basic American concept of a competitive market operating within a free enterprise system. The American economy has long been characterized by open markets operating with a minimum of government interference, except when clear economic or social justification can be shown for intervention. Historically, artificial price controls of whatever character have been rejected as being unacceptable mechanisms for allocating or pricing goods and services. As a form of price control, usury limits fare no better under contemporary analysis.

Two examples of government intervention in money matters make it unnecessary to speculate about whether non-market mechanisms are any more desirable. The first involves attempts to circumvent the open market system with government restrictions on the amount of interest being paid by financial institutions, commonly referred to as Regulation Q. Until recently, government controls on the amount of interest payable to depositors had created an ever-increasing divergence between what the law permitted depository institutions to pay and a fair, market return to consumers. Not suprisingly, the market found ways to avoid these limitations. For example, money market mutual funds filled this gap. Price controls calculated to "help" an industry only served to contribute significantly to its current problems.

The dramatic results of the newly authorized Money Market Deposit Account and the new Super NOW Account are prime examples of the market operating in a manner that benefits both consumers and financial institutions. There is no ceiling on the interest rates payable on these accounts, as they were designed to stem the flow of money out of the regulated depository institutions and into non-regulated financial institutions. The accounts have been enormously successful, attracting approximately $319 billion in deposits since December 1982.

A second example is provided by the piecemeal efforts—at both the state and federal levels—to deregulate price controls on money by lifting or changing some usury ceilings. Under the Depository Institutions Deregulation and Monetary Control Act of 1980 mortgage lending, and business and agricultural credit were afforded different treatment from that given to general consumer credit. This inevitable channeling of funds—regardless of the preferences of the consumer as to what he or she wants to use credit for—is descriptive of credit allocation not by the market, but by arbitrary, governmental-imposed rate ceilings.

Usury laws are nothing more than price controls that impose specific limitations on the price (reflected as interest or a time-price differential) paid for a specific commodity (the use of money). As with all such artificial governmental controls, the American experience has found them to be inefficient and unfair, producing inappropriate social and economic dislocations.

There is clear evidence that these disruptions have been produced by usury laws. An illustrative economic inefficiency is that lenders and other creditors are unable to charge prices for credit services that are commensurate with their costs. As we have seen, the matrix of usury laws and pricing restrictions creates a series of subsidies and dislocations—including cash purchasers subsidizing more affluent credit purchasers, and credit card users who use and pay for credit as opposed to convenience users who do not pay for a very valuable payment mechanism. As a result of these controls and restrictions, the cost to some consumers is too low, while that to others is too high.

In addition, the diversion and curtailment of credit can cause economic harm at a more general level. For example, a 1977 study of the Tennessee economy estimated that the state usury ceiling caused an annual loss in output of $150 million and the loss of 7,000 jobs.

Other examples of the substantial and adverse impacts of usury laws on the economy as a whole are shown by the experience of two major banks located in Maryland. During 1979 and 1980 one bank reduced its instalment credit portfolio by approximately 30 percent. One result of this change forced by state usury laws was that 27 positions—about 20 percent of the personnel handling this type of loan—were eliminated.

During the same period, in response to the increase in the cost of funds and state usury limitations, a second bank reduced its consumer credit portfolio by $200 million. That constituted a reduction of 25 percent of the total portfolio previously held by the bank. The result of this was a termination of 115 employees operating in that area, or approximately 25 percent of the total number of employees involved in consumer credit.

A further result was that a number of Maryland banks moved their credit card operations to Delaware. Subsequently, the Maryland State legislature enacted legislation to maintain its financial system. However, experience demonstrates that usury ceilings mean less credit, less credit means fewer purchases, fewer purchases mean less production, and less production means fewer jobs. The effects of credit ceilings are substantial and they are real.

In addition to these economic disruptions, usury laws have also given rise to geographical dislocations based on rational business decisions with respect to usury ceilings. As should be expected in a highly mobile society, recent changes in certain states' usury laws have produced positive responses from financial institutions large enough to deal with the substantial capital and set-up costs involved in moving to more favorable regulatory environments.

Among the factors considered by those involved in these activities is the ability to plan for future development and expansion in light of uncertain or shifting state interest rate decisions. Although temporary relief has been provided in some states, including New York, it generally is not permanent, and provides little basis for extensive future planning when the law affecting a major pricing issue remains in flux.

In short, the disruptions caused by government interference provide clear evidence that the general open market approach, that characterizes virtually all other segments of the American economy, should be applied to the credit markets. If, contrary to this general rule, credit is to be afforded unique treatment, there must be a clear justification for the continuation of price controls in the form of usury statutes. As the following discussion will demonstrate, however, no such justification now exists.

2. The arguments presented

Four general arguments are used to support usury laws. The first is that there is no effective competition in the credit industry, so that the termination of usury ceilings would result in radically high credit costs. The second justification is the fear that consumers are generally unsophisticated in credit matters and, therefore, are unaware of credit costs. This lack of sophistication, reflected by unawareness of credit costs, it is argued, will permit creditors to charge very high rates of interest if usury ceilings are eliminated. A third justification for the continuation of usury ceilings is that the limitation on the availability of credit caused by usury limits is a good social end since it protects consumers from "overextension" and saves them from the inevitable economic and social disruptions caused by overextensions, including litigation, foreclosures and bankruptcies. A fourth argument is that usury laws are necessary to prevent loansharking. All of these justifications for interest rate ceilings are based on unsupportable factual premises, and none of them has any relationship to contemporary American society.

A. The market is not monopolistic.—There simply is no support for the assertion that the credit industry is monopolistic. The credit market is composed of an increasing number of credit sources.

The current development of a well-populated, diverse, widely advertised and highly competitive market—composed of banks, finance companies, retailers and now new, short-term lending programs undertaken by credit unions, savings and loan associations and mutual savings banks—will cause an even more significant increase to the supply side of the lending equation.

The Federal Reserve Board studied a number of credit-granting firms and the degree of concentration in 213 Standard Metropolitan Statistical Areas and 233 county markets between 1966 and 1975. The conclusion reached by the Board was that more markets experienced structural changes that enhanced competition than changes that reduced it.

Competition in the credit industry can also be seen looking at the experience in states with no usury limits, or with very high usury limits. In California, where, in effect, banks are not subject to usury limits, there is simply no evidence that creditors are reaping unusually high rates of return. The National Commission on Consumer Finance confirmed earlier studies that actual rates tend to fall below the maximum usury rates when these maximum rate limits were in excess of the effective cost of providing "lendable" funds. Thus, from both a structural point of view and from an historical review of the experience in states not having usury limits, we find substantial evidence to indicate that the credit industry is competitive. The current existence of usury limits set below market rates creates a situation where many creditors are charging the same rates. It is hardly fair for those favoring usury limits to employ a principal symptom of these limits, namely the existence of identical rates throughout the industry in a given state, as a reason for the continuation of the limits.

Recent experience in the state of New York confirms the existence of a competitive market. New York has recently extended a temporary and limited lifting of interest rates. The New York State Bankers Association has conducted a survey on the interest rates charged on certain loans by twenty commercial banks in that state. The banks surveyed hold loan portfolios that encompass a substantial proportion of the consumer loans outstanding in New York State. The survey was conducted in February 1981, November 1982 and January 1983 (see Appendix A). Although the average interest rate has not changed dramatically, the interest rate range should be noted. In January 1983 the banks surveyed offered home improvement loans with interest rates ranging from 14.8 percent to 21.5 percent. Rates for new car loans varied between 13.5 percent and 21 percent, while interest rates on used car loans ranged from 14.8 percent to 24.5 percent. As the operation of credit card services is more expensive and complex than other types of consumer financial services, the annual percentage rates ranging from 18 percent to 19.9 percent demonstrated, as expected, less variation. These variations, hardly characteristic of a monopolistic situation, present consumers with alternative choices that can be identified through credit shopping.

Moreover, in analyzing competition, it is important to emphasize the anti-competitive impact of usury laws. The continued existence of usury laws discourages even more competitors from entering the credit market and may, therefore, encourage concentration. It is obvious that potential new entrants have little incentive to compete in the credit market when the rates they can charge are limited by artificial, government-imposed ceilings, while many of their costs are dictated by an unregulated market. That is particularly true since many of these credit programs involve substantial start-up costs that must be recouped before even considering the question of ongoing profitability. In the current economic situation, potential market entrants face a high risk and a small gain potential, largely due to the existence of usury restrictions.

The conclusion that usury ceilings deter new entry into the credit market was reconfirmed in the final report of the Interagency Task Force on Thrift Institutions. That Task Force, established by the Depository Institutions Deregulation and Monetary Control Act of 1980, analyzed the impact of usury laws on the participation of thrifts in more diverse consumer lending markets. It concluded that these ceilings discourage, if not prevent, diversification.

Furthermore, in some credit areas, usury laws, and efforts at avoiding them, may actually lead to greater market concentration. In the credit card area, for instance, some financial institutions in states with no or very high rate ceilings are purchasing the portfolios and programs of creditors that are located in low-interest-ceiling states. The purchasing institutions then market their programs in the low-rate states at market rates that reflect their real costs. One of the results of these activities—which merely reflect the logical workings of a financial market—is to reduce the number of competitors participating in these programs. Of course, consumers end up paying a market rate. Though that does not suggest the building of a monopoly, it is nonetheless somewhat troublesome both in terms of possible competitive impact and the political and social desirability of local control over these credit activities.

In short, the market is already extremely competitive, and we believe that competition would be enhanced even further if usury laws were set aside.

B. Consumers have a high level of cost awareness.—The argument that consumers are unaware of credit costs flies directly in the face of extensive private and government studies indicating that the literally millions of dollars spent by the credit industry on Truth in Lending disclosure activity have produced results. One study of bank credit card users found that for every 100 respondents in 1969 who did not know the annual percentage rate, only 50 had a similar response 15 months after the Truth in Lending Act became effective. This level of awareness has continued to grow. In a 1975 study of the awareness of the annual percentage rate in connection with revolving credit, one researcher found a 56.7 percent awareness rate for the total sample. A 1978 study of California bank cardholders found that almost 80 percent of the sample knew the annual percentage rate. In a study conducted by the Federal Reserve Board it was found that, between 1969 and 1977, the awareness of closed-end credit annual percentage rates increased from 14.5 percent to 54.5 percent. Awareness of rates for bank credit cards during the same period increased dramatically, from 26.6 percent to 71.3 percent. Without question, these levels of awareness are adequate to assure rate competition among credit grantors.

Consumers are intelligent and informed about credit costs. They "shop around" for a good return on their investment, as evidenced by the success of the money market funds and the new deposit instruments offered as a result of the recent Garn-St Germain legislation. In the same vein, in order to remain in business, banks must offer interest rates on loans that will attract today's educated consumers.

C. Consumers are not overextended.—The argument used in support of usury limitations is that such limitations save consumers from overextending themselves. This "non-economic" argument for the continuation of usury ceilings is really just the current version of the traditional social and religious view of interest and lending as an evil. The argument that consumers have insatiable credit appetities that are being held in check by usury limitations is not supported by any empirical data. Indeed, this argument has been refuted by studies that show that growth of credit outstandings is basically similar to the rate of inflation. The fact that consumers are not "overborrowing" has also been shown by private studies using a variety of income statement and balance sheet approaches.

D. "Loansharks" are not deterred by usury laws.—The final argument suggests that usury ceilings somehow deter loanshark activity. In the first place, it is highly unlikely that loansharks are going to be greatly influenced by any form of legal constraints. There is absolutely no evidence whatsoever to indicate that they follow usury laws. On the contrary, all evidence demonstrates that usury laws hurt only legitimate credit grantors.

Similarly, the use of these laws as a mechanism to prosecute loansharks is not needed since numerous state and federal laws currently provide criminal penalties. It is difficult to imagine a loanshark making Truth in Lending disclosures or meeting the duties imposed by the many other state and federal consumer credit protection statues. Moreover, if the activity giving rise to concern is truly loansharking, Title II of the Consumer Credit Protection Act of 1968 currently proscribes that activity and imposes substantial penalties on those who violate the law by authorizing fines of up to $10,000, 20 years in prison, or both.

Conversely, it is clear from a variety of studies that below-market-rate ceilings drive borrowers from traditional credit markets to credit sources that present substantially greater risks. The lower the rate ceiling, the greater the driving force toward illegal lending activities. The only effective method of preventing loansharking is to allow access to legitimate credit markets by permitting the free market to operate.

In summary, Mr. Chairman, the four bases cited for the continuation of usury laws are simply without foundation in today's society. As in other attempts at placing economic controls on our economy, government price controls do not produce benefits to the market or to those it serves.

USURY ACTUALLY HARMS THE CONSUMERS IT IS SAID TO HELP

As Secretary of the Treasury Donald T. Regan testified April 6, 1983 before the Senate Committee on Banking, Housing and Urban Affairs:

The removal of usury ceilings would also benefit borrowers by making it easier for them to obtain credit. The Administration believes that usury ceilings only distort financial markets and credit flows and do not reduce the cost of credit to the economy. Institutions are more likely to lend to all types of borrowers if loans can be priced to reflect the risk exposure.

Not only do these artifical price controls fail to produce positive benefits, but they actually damage both the economy and the very consumers they are said to protect. For example, usury laws severly limit the availability of credit when the market rate for money exceeds the maximum rate set by the states. Testimony presented before the Consumer Affairs Subcommittee of the Senate Banking Committee in March 1983 demonstrates this problem. Recent studies of major banks in Massachusetts provided vivid evidence of the problems produced by usury laws. In 1979 and 1980 the firm of Peat Marwick, Mitchell & Co. analyzed bank credit card operations. The Massachusetts Bankers Association updated the studies in 1981 and 1982.

The studies revealed that the banks surveyed in 1979 *lost* $13.74 on each credit card account. By 1980, that amount had increased to $19.67, and in 1981 to $24.06. In 1982, the *loss* was minimized because the cost of funds had decreased, and banks had been permitted to impose fees since 1980 that helped to cover their expenses. Even so, banks still *lost* $2.13 on each account in 1982. On a per-transaction basis, each time a consumer used his or her bank credit card in 1979, the bank *lost* 81 cents. In 1980, the banks *lost* $1.23 on each credit card transaction. In 1981, the *loss* increased to $1.38. In 1982, the *loss* decreased to 11 cents a transaction, but again the loss was minimized because fees were permitted and the cost of funds had decreased during that year.

In 1979 the seven banks surveyed suffered a net, before-tax loss of $15 million on their credit card operations. The 1980 figures showed a total loss of $20.5 million, despite the imposition of membership fees by six of the seven banks surveyed, which brought in $3.8 million in new revenues.

In 1981 the loss rose to $23.4 million. In 1982, the loss was $2.5 million. The decrease was primarily due to increased membership fee revenue, a higher average gross interest yield on outstanding credit card balances and a lower average cost of funds. It should also be noted that the cost of funds needed to support the outstanding balances rose from $36 million in 1979 to $45.4 million in 1980. In 1981 this figure was $55.9 million and in 1982, $50.9 million. Thus, even though the losses in 1982 decreased, each of the banks surveyed has still lost money on its bank credit card program.

Due to the value of these programs to their customers and to banks' overall service packages, many banks have continued to offer these programs (though a number have withdrawn). However, as these figures demonstrate, this simply cannot continue indefinitely. Quite clearly—in view of the current cost of funds and the government limited prices on credit services—many banks facing this situation will have to reduce credit availability and will ultimately be forced to terminate this form of open-end credit plan.

The reduction in available credit is not limited to open-end credit. As a direct result of usury limitations, one major Pennsylvania bank reduced installment loans by almost 37 percent between 1978 and 1980. During the same period that bank had to respond to usury limits by reducing the number of new open-end accounts by almost 50 percent. Similarly, in Michigan, three of the larger retail lenders reduced their installment loans by 44 percent between 1978 and 1980. In 1982, the volume of installment credit had decreased by 68 percent, compared to 1978 data.

The first consumers injured by the reduction in the supply of credit caused by usury limitations are the less affluent. Since the economic return of creditors is in large measure based on the risks of repayment, any reduction in the supply of money for lending will cause creditors to lower their risk factors for the funds actually lent. Accordingly, those consumers with lower credit ratings, lower incomes and a higher incidence of unemployment will almost certainly be the first to be excluded from the credit pool. Absent a conclusion that deprivation is the equivalent of protection (an argument described and refuted earlier in our testimony), the end result is that those who are the intended beneficiaries of usury laws are, in fact, the consumers most adversely affected by them.

FEDERAL RELIEF IS APPROPRIATE

For all of the reasons briefly set out above, the Association believes that the time for usury relief is now and that it is appropriate—in fact, essential—that it be provided at the federal level. Rates are lower now, but the availability of credit is still hampered by the unpredictable nature of the present economy and the fear that recent problems will recur. The elimination of usury limitations would not result in higher rates, but would permit those who need credit to obtain it. We respectfully urge that Congress take immediate action on this problem.

We recognize that our suggested solution for this problem, namely the federal preemption of state usury laws, will cause concern to those who favor the continuation of the prerogatives of state government. Although most usury laws have been enacted at the state level, there are many reasons for suggesting that federal relief is both appropriate and necessary. We think that the following factors particularly recommend congressional action:

1. The continuation of usury limitations has an important adverse impact on the national economy.

2. Congress has not abandoned this area of law to the states, but rather has maintained an active involvement in the field. As a particularly important example, the cost of the funds used for lending is, in large measure, the result of federal activity. In addition, recent federal legislation and DIDC action have effectively deregulated the liability (deposit) side of the balance sheet, while the asset side is still hampered by state-imposed price controls.

3. The need for immediate uniform relief can only be met by Congress.

1. The negative impact on the national economy

As indicated earlier in our testimony, the most predictable result produced by state credit cost ceilings that are below market rates is the unavailability of credit. If the action of any given state legislature would injure only the residents of that state, then we would see some merit in treating the problem at the state level. It is impossible, however, to limit the damage done by usury ceilings to the geographical boundaries of any state.

The obvious results of artificially set interest rate limits are homes unbuilt, automobiles not purchased, home improvements delayed, vacations forgotten and education plans revised. In a very real sense, the persons injured by the usury limits of Pennsylvania, are the workers and stockholders of industries whose demand is cut by the reduction in credit availability. Without question, the small business operator in Texas, the ski area owner in Utah, the maker of aluminum siding in Pennylvania, the auto worker in Detroit, the farmer in Illinois and the airline pilot in Hartford, can all be injured by the interest rate decisions made by the state legislature of New York. These problems mean that even states that have acted to change their rate ceilings are directly affected by the usury problems of other states. To fail to see interest ceilings as a federal problem is to lose touch with the reality that credit flows through and directly affects a national economic system that operates without regard to political boundaries.

It is also important to recognize, that the credit industry is itself fast becoming a national industry. The nationwide marketing of bank credit cards, the national presence of General Motors Acceptance Corporation, Sears and J.C. Penney, and the daily presence of American Express advertisements all suggest that consumer credit is a national resource. It is simply unrealistic at this stage to suggest that creditors who sell their product (the availability of funds) on a nationwide basis must stay alert to and carefully follow the patchwork of state usury laws that govern consumer credit transactions. It seems inconceivable that anyone would advocate that states should be allowed to impose price controls on other commodities that flow in interstate commerce.

2. Federal participation in usury has been substantial and longstanding

A. Federal involvement has extensive precedent.—Although there has been substantial state involvement in the establishment and maintenance of usury ceilings, it is simply inaccurate to view usury as a state prerogative that has been untouched by federal law. The federal government has been involved in usury matters for many years. Under existing federal law, state usury laws for certain types of credit transactions have been totally displaced, and state usury laws relating to all types of transactions have been preempted (at least to some extent) for federally chartered and federally insured financial institutions.

For half a century national banks have had a permissive maximum usury ceiling in connection with all loans. In 1933 Congress established a permitted-interest rate ceiling for national banks that was tied to the Federal Reserve Board's discount rate. State usury laws that were below the established level of 1 percent over the prevailing discount rate were preempted.

The recognition of usury as a national concern has also been reflected in more recent legislative activity. In response to specific problems resulting from 10 percent usury limits (imposed by state constitutions in Arkansas and Tennessee and by statute in Montana), Congress provided for limited federal preemption for the period from October 29, 1974 to July 1, 1977. (Act of October 29, 1974, Public Law Number 93-501, 88 Stat. 1557 (1973).) Similar relief as to specific types of credit was sought and obtained in 1979, as costs of funds increased dramatically. The interim legislation affecting mortgage loans and large business and agricultural loans was adopted on December 28, 1979. (Act of December 28, 1979, Public Law 96-161 (1979).)

Shortly after this interim legislation was adopted, Congress passed a more durable measure that preempted usury limits at least partially in three areas. (Act of March 31, 1980, Public Law Number 96-221 (1980).) This legislation, part of the Depository Institutions Deregulation and Monetary Control Act, preempted state usury laws that limit the rate or amount of interest, discount points and finance charges that may be charged in connection with real estate mortgages and—if the contract contained specified provisions—the financing of manufactured housing, including mobile homes. States may, of course, reimpose their own usury ceilings within a three-year period, and several have already done so. It also preempted for three years state laws in connection with business and agricultural loans of more than $25,000 (an amount that was later reduced to $1,000). This preemption remained subject to an overall rate limitation of 5 percent over the Federal Reserve's discount rate, including any surcharge then in effect. (Appropriately, S. 730 abolishes the concept of an alternative federal ceiling indexed to the discount rate, as the experiences of the last three years have proven that this policy is unworkable.)

Finally, the 1980 legislation provided for the preemption of state usury laws for all loans made by state-chartered, federally insured institutions, subject to a ceiling of 1 percent above the Federal Reserve's discount rate (placing them on a par with national banks).

These federal preemption provisions give strong evidence not only of federal involvement in the usury area, but also of the fact that congressional scrutiny of state usury ceilings has resulted in their being overridden. Thus, the action our Association recommends has solid congressional precedent.

B. Other Federal regulatory actions have affected the impact of usury laws.—In addition to its direct participation in setting or totally lifting usury ceilings, the federal government has played a substantial role in those factors that magnify the economic and social obsolescence of usury limits.

During the past decade Congress has passed a virtual avalanche of new laws affecting creditors, many of which are implemented through complex regulations. These federal laws, in most cases preempting state laws, reflected federal decisions about the need for an appropriate level of consumer protection.

This extensive participation of Congress in the credit industry has resulted in a direct shifting of responsibilities and costs between consumers and creditors, and to varying degrees has imposed substantial costs on creditors. A long list of consumer credit provisions can be cited, including:

Truth in Lending Act
Truth in Lending Simplification and Reform Act
Fair Credit Reporting Act
Fair Credit Billing Act
Equal Credit Opportunity Act
Fair Debt Collection Practices Act
Electronic Fund Transfers Act
Home Mortgage Disclosure Act
Real Estate Settlement and Procedures Act
Fair Housing Act
Flood Disaster Protection Act of 1973
Community Reinvestment Act
Interstate Land Sales Full Disclosure Act
Right to Financial Privacy Act of 1978

Each of the foregoing acts has imposed certain duties on creditors. In an attempt to enhance the rights of consumers, all of these acts have involved at least some costs. For example, one Federal Reserve study estimated that the cost of implementing Regulation B, promulgated under the Equal Credit Opportunity Act, cost creditors $294 million. According to a survey of Regulation Z compliance costs to the mortgage banking industry, conducted by Louis Harris and Associates for the Federal Trade Commission, the average expenses as a result of Reg Z falls disproportionately on small mortgage banking firms. In addition, the study indicated that in 1981 large firms (assets over $200 million) spent about 29 cents per thousand dollars of mortgage loans to comply with Reg Z, midsized firms (assets $50-$200 million) spent about 54 cents, and small firms (assets less than $50 million) spent about 89 cents per thousand dollars of mortgage loans to comply with the Regulation.

Although we understand that Federal Trade Commission Chairman James C. Miller III has cautioned against the use of these specific figures as true estimates of industry costs, we believe that the study underscores the fact that compliance has added to the cost of credit. Indeed, in may instances the additional costs have been acknowledged, but the congressional judgment has been that the increased protections to consumers are worth the resulting increase.

The advent of a wide array of federal statutory and regulatory duties, limitations and prohibitions has created costs that creditors are often unable to recover through higher interest prices because those prices are limited by state usury laws.

C. The Federal role in regulating—and now deregulating—The cost of funds has directly affected credit costs.—An additional and perhaps the most important factor in considering the federal role in the usury law question involves the recent deregulation of a major portion of a bank's cost of doing business, the cost of funds. Since the early 1930s the rates paid by banks on deposits have been regulated by the federal government. These rate limits have had their principal impact since 1966, when these ceilings had the effect of differentiating maximum permissible rates among different types of depository institutions and artificially reducing the cost of funds to banks.

The six-year phase out of Regulation Q and the introduction of NOW accounts as a national product were both provided in the 1980 Deregulation Act. The Depository Institutions Deregulation Committee published a final regulation schedule that spells out in timetable fashion the demise of remaining rate limits on deposits. The regulations deregulate interest rate ceilings according to the maturity of the deposit. Under the regulation, interest rate ceilings on various maturities will be eliminated in accordance with a fixed deregulation schedule that will remove all deposit rate ceilings by March 31, 1986. Most importantly, the ceilingless Money Market Deposit Account and the Super NOW Account, authorized by the Garn-St Germain Depository Institutions Act of 1982, have as a practical matter, deregulated a substantial portion of financial institutions' deposit bases. Clearly, the increased rates that depository institutions are paying and will pay to their depositors will increase the cost of funds.

This action removes the final vestige of the federal government's longstanding role of limiting the costs of funds to deposit-taking institutions. Thus, the federal government, particularly by actions taken in the early 1930s and the early 1980s, has had a significant effect on the pricing of the cost of funds for credit extensions. Since financial institutions must pay a market rate to attract deposits, the continued imposition of usury ceilings will surely contribute to the very troublesome prospect of severe financial problems within the industry. As a consequence, consumers confidence in the system could erode creating even more problems in the economy. It is simply illogical to ignore this substantial federal involvement when considering the pricing side that now remains subject to state law.

D. Conclusion: The Federal role in usury has been substantial.—The response to the argument that usury laws were and remain the appropriate and exclusive province of the state is that this suggestion is factually inaccurate. Both direct and indirect involvement of the federal government have existed for half a century, a trend that has accelerated rapidly in the past decade. In the limited displacement of state usury ceilings, the imposition of new responsibilities that produce costs, and the participation is setting—and then deregulating—maximum deposit rates that directly affect the costs involved in lending, the federal presence in the usury area is established and apparent. It is nether improper nor inappropriate for the federal government to recognize the effects of its cost-generating activities by also dealing with the pricing side of the equation.

3. Timely, uniform relief is afforded only at the Federal level

Moreover, Mr. Chairman, only federal legislation is capable of producing the rapid response needed to provide relief from archaic state usury laws. The alternative is a gradual series of state legislative pronouncements that *might* be adopted and, even then, only after extended discussion and debate that doubtless will produce a broad array of different types of provisions. Insofar as there has been a state response, in many cases, only temporary relief has been provided. Multiple diverse rules, many only of brief duration, adopted over a span of years simply will not respond to the immediate needs presented by the dynamic market forces that operate at a national level.

In view of today's national credit market, a state-by-state, piecemeal approach simply will not work. Multi-state creditors cannot operate efficiently if subject to a constantly changing patchwork of rate ceilings. Long-range planning efforts have become meaningless, since predicting the duration and nature of the responses by a large number of legislative bodies is impossible. Perhaps most important is that a growing number of states have rejected usury ceilings. They provide increased opportunities for financial institutions to offer credit at market rates. This means that as a practical matter even some consumers in low-rate states who want credit will often be able to obtain it from out-of-state sources at market rates. Thus, insofar as justification for continued state action is based on "protecting" consumers from market rates, that objective has been thwarted by the workings of the market.

History has shown that attempts to provide a uniform and reasonable usury ceiling at the state level have fallen short. In the later 1960s, and again in the early

1970s, the Uniform Consumer Credit Code was proposed by the National Conference of Commissioners on Uniform State Laws. This comprehensive legislative effort operated from the premise that a competitive market—assured by very few barriers to market entry for potential creditors—should be allowed to operate within usury ceilings that, at the time of their adoption, were very high. Essentially, the UCCC provided interest rate ceilings of 36% for loans up to $300 or less, 21% for loans of $300 to $1,000, 15% for loans greater than $1,000, or at an alternative flat rate of 18%. Yet, in response to this massive effort, only twelve states have adopted the UCC—fully or partially—since it was first proposed in 1969.[2]

Both inertia and political pressures at the state level appear to explain the retention of usury ceilings or the tendency to provide only limited and somewhat arbitrary exceptions.

The speed and consistency necessary to address the usury ceiling problem are not available at the state level. Federal action is the only realistic avenue for usury relief.

PENDING LEGISLATION

Mr. Chairman, we believe that legislation now before this Committee would provide this relief. The Credit Deregulation and Availability Act of 1983, introduced by you, Senator Proxmire and Senator Lugar, will do much to alleviate the problems that we have discussed today.

This important legislation would provide relief in two areas. The first involves consumer credit transactions, and the second relates to business and agricultural credit. We would like to coment on both of these aspects of S. 730.

The basic thrust of the consumer credit provisions is to release the market from artificial constraints, permitting the highly competitive consumer credit marketplace to establish rates. This allows creditors to make credit available to consumers who want it at a price based on the costs involved. The bill permits the market to establish both the shape and the level of the charges being assessed. Consumers are protected from unreasonably high rates by market mechanisms. We consider this to be the most important feature of the bill.

The absence of an arbitrary "cap" and the consequent working of the market is the only way to assure the reasonable availability of credit. Any rate restriction has the effect of denying credit availability. The diversity of credit transactions involved cannot be covered by a single rate. The risk involved, the dollar amount, and the term of the transaction are only a few of the multiple factors that make one rate inappropriate.

Moreover, setting a specific rate involves either looking at current market rates or making predictions about future market conditions. Neither alternative is desirable. Seizing on current rates generally involves setting a static limit based on today's situation. That approach seems certain to assure a perpetual series of rate changes through attempts to keep up with market changes—a process unlikely to be responsive in a timely manner to market shifts. Predicting future rates seems equally impossible. If nothing else, the past four years have served to remind all of us that the market does not always perform predictably.

By the same token, attempts at seeking an appropriate index have consistently failed. In our experience there is no index that accurately reflects the multitude of factors that must be included in pricing credit services. We have analyzed virtually every known index and none will provide an accurate indication of the market cost of funds as those costs relate to both long- and short-term transactions.

Perhaps the best example of the difficulties involved in selecting an index has been the suggestion that we look to the Federal Reserve Board's discount rate. The Association would respectfully suggest that the discount rate is simply an inappropriate measure as it is an administered rate on short-term funds, calculated primarily on the basis of monetary policy. It bears no direct relationship to the creditor's cost of funds, let alone the other costs associated with lending. Perhaps more important, this rate may be altered for reasons quite separate and apart from anything having to do with the cost of funds. As Vice Chairman Schultz of the Federal Reserve Board testified in 1980 before the House Committee on Small Business, the use of the Federal Reserve discount rate is an inappropriate measure to use in attempting to set rate levels.

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[2] Various sources cite different figures respecting the number of states that have "adopted" the UCCC, depending on the extent to which the model code was followed. These figures generally vary from six to twelve states.

In light of the economic problems caused by price controls and the availability of a competitive open market as a mechanism to set the price of credit, it is difficult to justify the need to set any ceiling. As described earlier, the traditional justifications no longer support the continuation of usury ceilings.

Thus, this legislation properly allows the market to set rates. While relieving price controls, S. 730 would leave in place the state consumer protection provisions. Presumably, state laws that deal specifically with rates or charges would be displaced. This permits the states to respond to specific difficulties that they may encounter in dealing with abusive credit practices unique to their states, while at the same time permitting creditors whose costs are largely influenced by federal action to recoup those costs.

However, Mr. Chairman, we note that the language of S. 730 differs somewhat from last Congress's legislation (S. 1406 by Senator Lugar) in one aspect. The definition of "covered charges" (Sec. 532(a)(1)) has been narrowed. The section-by-section analysis reflects that states will still be allowed to place price controls on many aspects of a credit transaction. This contraction may have resulted from previous consumer group testimony that inaccurately alleged that state laws limiting charges on insurance premiums, title and closing fees, late charges, attorney fees and court costs would be preempted. Though S. 730 clearly addresses these concerns, we have several reservations that certain charges directly determinate of rates will still be under state price controls. For instance, state restrictions on rebates and other charges for prepayment would not be preempted. Prepayment charges, equivalent to a "minimum interest" charge, are incurred by borrowers whenever they decide to terminate the contract earlier than originally agreed. Lenders are compensated in this manner because the original contract contemplated that a certain amount of interest would be paid, and early termination changes the initial assessment of return. If states are permitted to severely restrict such charges, lenders will be forced to impose higher rates on all consumers in order to prevent losses. Therefore, we believe that the new definition and section-by-section analysis denies lenders much-needed flexibility.

We are also concerned that the legislation continues to contain the state opt-out provision. One of the primary thrusts of this legislation is to allow capital to flow freely between states. As we previously pointed out, states that impose ceilings affect commerce among all the states. To allow the opt-out provision could lead to the reinstatement of the patchwork pattern which would frustrate the intent of the legislation.

Finally, the Association strongly supports the provisions in S. 730 that permanently remove remaining interest rate ceilings that apply to business and agricultural credit. The changes reflected in the bill are totally appropriate, given the desirability of market-determined operations. We also endorse the abolishment of the index that had applied to business and agricultural credit for reasons we have already stated in this testimony.

CONCLUSION

In conclusion, Mr. Chairman, usury relief is essential to our industry. As in other segments of our economy, the imposition of arbitrary price controls—by whatever level of government—is simply inconsistent with the proper and efficient operation of an open-market economy.

The Association respectfully urges early and favorable action on S. 730, which would provide essential relief in this most important area. Thank you.

APPENDIX A.—NEW YORK STATE BANKERS ASSOCIATION

	February 1981	November 1982	January 1983
Home improvement loans:			
Average [1]	18.2	18	17.6
Range [2]	16.3–20	14.4–21	14.8–21.5
New car loans:			
Average [1]	17.4	17	16.6
Range [2]	15–19.6	13.4–21	13.5–21
Used car loans:			
Average [1]	18	18.6	17.9
Range [2]	15.5–19.6	14.4–21	14.8–24.5
Credit cards:			
Average [1]	16.8	19.3	19.2

APPENDIX A.—NEW YORK STATE BANKERS ASSOCIATION—Continued

	February 1981	November 1982	January 1983
Range [2]	12-19.8	18-21	18-19.9
Cash advances:			
Average [1]	16.3	19.3	19.1
Range [2]	12-19.8	18-21	18-19.9
Overdraft checking:			
Average [1]	16	18.6	18.4
Range [2]	12-18	17.5-19.8	13.5-20

[1] Average of rates offered in percents

[2] Range of rates offered in percents

The CHAIRMAN. Mr. Evans.

ROBERT B. EVANS, PRESIDENT, AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. EVANS. Thank you, Mr. Chairman. My name is Robert B. Evans, president of the American Financial Services Association.

If I'm allowed one short commercial here, I'd like to point out that our name used to be the National Consumer Finance Association. I believe our members wanted us to be more attuned to the times, so we now must be a financial services organization.

That's accordingly our name. We now account for about 28 percent of the consumer credit outstanding. That's about $94 billion out of $340 billion, which is up considerably from where it was about 7 years ago when I first came down to testify about truth in lending.

We wholeheartedly support, Mr. Chairman, S. 730, and we appreciate your reintroduction of the preemption legislation.

I'd like to point out just briefly that although many States have acted in the last few years to increase their ceilings and to deregulate, most of these were accompanied by a sunset provision.

We're not out of the woods yet by any means. Across the country we know that the sunset provisions will take effect and the rates will be reduced, and during the next credit crunch—I hope we don't have one—we'll be fighting the same battle all over again.

Further, we've had a very good experience under the deregulation that was accomplished not so long ago in the case of manufactured housing. One of our major members, GE Credit, was very broadly engaged in the financing of manufactured housing and has informed us that in 33 of the 41 States in which they continue to finance in this area, they used the Federal alternative rate.

So, you can see many, many people were benefited and were thereby enabled to obtain housing during a very critical period when other housing could not be obtained to finance.

Let me turn just briefly to some of the statements of our opponents on this legislation. Quite obviously, deregulation can be accomplished. Many States have done it and the results have been quite good over all.

The consumer protections have remained intact. If you just look at page 11 of our statement, you will see literally dozens upon dozens of consumer protections, for instance, that remain in existence, and these, of course, have to be considered along with the Federal protections.

Finally, some of the examples provided by the evils of deregulation simply are inapplicable because they break exisiting laws, as was pointed out by a witness earlier.

These people charging 80 percent simply don't have a regard for any kind of law or any ruler regulation of any kind, and until somebody enforces existing laws, they're going to get away with it.

I have heard reports that the suggestion that a plain language requirement be incorporated in this bill. It might help you to know that out of the $94 billion of financing that we're engaged in by our members, probably about $75 billion of .that is in plain-language form right now.

I'd point out that Households International, GMAC, and Ford Motor Credit are among the major institutions that have this.

Finally, a question has arisen before you in this committee and presently in Senator Hawkins' hearings. It relates to whether or not the rate being charged by one of our major members in these promotional financings that have taken place; namely, GMAC—whether their specials of 1982 of 12.8 percent and 10.9 percent were subsidized or nonsubsidized rates.

The contention has been raised twice that these are not subsidized rates, these are really market rates. Therefore, every other financial institution should be charging the same.

That's simply not true. These quite clearly are subsidized rates. I'll give you the overall cost of funds to GMAC in 1982 in case you believe that might not be the case. It was 11.77 percent. In 1983, it's 13 percent.

So, it's quite obvious that these are a subsidized rate and they're using the specials in order to help the sale of cars, which was the basic problem.

The fact that they made a profit does not militate against this or vice versa, because this applies to a very small portion of the total financing of $23 billion in retail contracts that GMAC for instance extended last year.

Further, they have a stock of contracts that goes back over a 3-year period, which would account for their profitability. They simply subsidize these rates; it's not a market rate.

I'll be glad to respond to any questions you have, Mr. Chairman.

[The complete statement follows:]

Statement of

ROBERT B. EVANS

President

AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. Chairman and Members of the Committee:

My name is Robert B. Evans, President of the American Financial Services Association (AFSA).* Organized in 1916, AFSA is the national trade association of non-bank financial services companies. AFSA represents over 580 companies operating more than 15,000 offices serving the public throughout the country. The membership of AFSA is highly diversified ranging from single small loan offices to substantial nationwide organizations engaged in unsecured direct lending, second mortgage lending and the financing of the sale of durable goods. In sum, the consumer finance industry accounts for approximately one-fourth of all consumer credit extended or approximately $94 billion of the $343 plus billion outstanding.

AFSA greatly appreciates this opportunity to appear to present its views on S. 730, the Credit Deregulation and Availability Act of 1983.

As a general proposition, AFSA supports federal preemption and deregulation of state credit and usury ceilings. These limits, whether bearing the appellation "usury limits" or "rate ceilings" are simply price controls imposed upon the "use" of money. Federal preemption of business and agricultural loan ceilings is a natural step in the orderly progression of the deregulation and restructuring of the nation's financial institutions. Indeed, it follows that - if the largest group of creditors in the country may not charge market rates for the use of their funds - other creditor groups who borrow from them must be accorded the same privilege. This "largest group" consists of individual savers, the source of virtually all savings. With the emergence of money market rate accounts, the individual saver is now able to command market rates for his funds; naturally the financial intermediaries which employ these funds must be free to do the same or forego lending when market rates exceed any statutory ceiling.

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* The Association's corporate name, formerly National Consumer Finance Association, was officially changed on February 1, 1983.

This issue is particularly vital to the financial services industry, particularly during times of violatile money costs. Unlike depository institutions which may curb lending and continue to retain their consumers through savings, checking or trust services, a sales or commercial finance company's sole relationship to a customer is the extension of credit. Turning down a customer translates to losing that customer.

I. BUSINESS AND AGRICULTURAL CREDIT

AFSA urges that the Congress make permanent the preemption of state interest rate ceilings for business and agricultural loans and amend the current statute to deregulate all such extensions of credit.

Financial services companies floor plan commercial motor vehicles, agricultural implements and tractors, retail goods and engage in direct financing or factoring for many businesses. Usury ceilings which vary from state to state and contain sunset provisions make strategic planning very difficult in this type of financing. Financial services companies are forced to shift their assets into higher yield states when money costs preclude extending business credit in certain states, resulting in denial of credit to small business.

In contrast, federal intervention and deregulation of state usury ceilings on manufactured housing provides an instructive example. Many state rate restrictions on manufactured housing have proven insufficient to provide consumers funding for the purchase of new homes. The federal preemption provided in the Depository Institutions Deregulation and Monetary Control Act of 1980 was successful in providing funding for manufactured housing. The experience of a large financial services company reflected that by 1981 that company operated under the federal alternate rate in 33 of the 41 states in which that rate was applicable. Had that option not been open, the borrowers from the company may have been turned away when seeking financing. We urge Congress to extend the same flexibility to business and agricultural credit.

AFSA urges the Congress to view this issue with a long-term historical perspective. Although the prime lending rate is lower today than in the immediate past, it is still much higher than it has traditionally been. While not a perfect indicator, it is reflective of money costs and the attached chart reflects the wide variation of recent years.

II. CONSUMER CREDIT

A. AFSA Supports Federal Preemption of State Usury Ceilings and Urges Parity Among Financial Institutions

AFSA wholeheartedly supports the consumer credit provisions of S. 730. The financial services industry is unique among the financial institutions advocating federal preemption. While there is remarkable unanimity among federally regulated financial institutions that preemption is desirable, our industry, which is universally licensed, regulated or operating pursuant to state law also supports federal preemption.

Much federal legislative effort has gone into the creation of a "level playing field" upon which all financial institutions may compete equally. While to a large extent federally chartered institutions have received such treatment through legislation and judicial decisions which have expanded the powers of "most favored lenders", financial services companies are in fact the least favored lenders.

Since the National Bank Act of 1864, federal banks could charge the rate permitted state banks under state law, even if the state rate exceeded a national ceiling. This rule, aptly named "the most favored lender doctrine", continues in today's National Bank Act, and friendly administrative agencies have expanded its interpretation.

The right of a national bank to charge the rate permitted in the state in which it is located was construed by the Supreme Court to allow the application of that rate to a consumer in another state, even if the consumer's state of residence allows a lesser rate. Marquette National Bank of Minneapolis v. First of Omaha Corp., 439 U.S. 299 (1978) allowed the servicing of Minnesota residents by a Nebraska bank at the higher Nebraska rate. This ability to export interest rates does not accrue to a consumer finance company or a retailer. Today a national bank chartered in Delaware may issue credit cards to consumers throughout the country under Delaware's deregulated rates. A finance company or retailer doing business in Delaware may issue credit cards or make loans to consumers throughout the country only under the rate permitted by the consumer's state of residence. This discrimination against non-federally chartered institutions can only be ended through a national preemption of state usury ceilings.

The financial services industry is subject to considerably greater restriction in the employment of its assets than our competing financial institutions. These state-imposed restrictions include: 1) limitations on the amount and duration of credit that may be extended; 2) limitations on the type of property which may secure an extension of credit; and 3) extraordinary penalties for violations of contract terms. AFSA does not, however, seek federal preemption of these restrictions, merely the deregulation of the rate component. We believe that "deregulation" of such state-imposed restrictions should - and will - come from the states as a by-product of rate deregulation.

B. Previous Federal Preemption of Consumer Rates

The Congress, various administrative agencies and progressive state legislatures have already, to a large degree, recognized the social benefit of deregulating interest rates. In the Housing and Community Development Amendments of 1979, Congress preempted state ceilings on second mortgage lending which restricted the federal housing administration's Title I Home Improvement Loan Program. In the Depository Institutions Deregulation and Monetary Control Act of 1980, Congress preempted state usury ceilings on first mortgage loans, manufactured housing loans and provided parity of powers for state chartered federally insured financial institutions.

Administrative agencies have also recognized the desirability of preemption. In its 1980 report to Congress, the Interagency Task Force on Thrift Institutions concluded that usury ceilings produced undesirable economic effects and recommended that Congress override such restrictions for consumer lending.

Last week, the Secretary of the Treasury testified in favor of this Title affirming the Administration's strong support for removal of usury ceilings. Secretary Regan stated:

> The removal of usury ceilings would also benefit borrowers by making it easier for them to obtain credit. The Administration believes that usury ceilings only distort financial markets and credit flows and do not reduce the cost of credit to the economy. Institutions are more likely to lend to all types of borrowers if loans can be priced to reflect the risk exposure.

He also noted that S. 730 does not interfer with the states' authority to impose consumer protection provisions on credit transactions or their ability to regulate creditors.

C. Deregulation and Consumer Protection

This ability to regulate creditors remains untouched. Opponents of interest rate deregulation at every level have often raised the specters of legalized "loan sharking", unregulated default and prepayment penalties, wholesale increases in the use of balloon notes and have even claimed that attorney's fees on default would rise. These emotional issues are simply false.

S. 730 simply removes rate ceilings while leaving untouched state consumer protection laws. State restrictions on prepayment penalties, rebates, methods of calculating interest, e.g., the precomputed, add-on, or discount methods, limiting the refinancing of balloon notes, and statutes mandating the use of "plain English" would remain untouched.

This bill leaves undisturbed the full panoply of consumer protections. Consumer Finance companies are licensed and regulated in every state in which they operate. The licensing often includes an investigation of the applicant's character, fitness, and financial stability. Regulatory requirements include examination by state examiners for compliance with state and federal truth-in-lending disclosures, compliance with the refunding provisions and a supervision of collection practices.

While compliance with the maximum state rates would be eliminated through the passage of this legislation, compliance with all other state regulations will continue. Virtually every state has a commissioner of consumer credit charged with the regulation of consumer finance companies. Every state has required disclosures for each type of consumer credit; fifteen states have requirements which substantially parallel the federal Truth-in-Lending Act. Forty-eight states prohibit deceptive advertising.

Virtually all states have adopted some form of statutory repossession procedures by which personal property may be recovered if wrongfully taken. Credit insurance is reserved to state control; every state has its own comprehensive act regulating the sale of credit related insurance, the premiums for such insurance and providing penalties for violations.

These protections will remain undisturbed by S.730 and compliance will continue to be measured by the state commissioners of consumer credit. Just as banks and savings and loan associations continue to be regulated, even where their first mortgage rate ceilings have been deregulated, the financial services industry will remain highly regulated under this bill.

1. Deregulation and UCCC Consumer Protections

The Uniform Consumer Credit Code (UCCC) provides the basic consumer protection law for Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah and Wyoming.

Only those provisions of the UCCC involving rate ceilings are removed by S. 730 - all other forms of consumer protection remain:

a) Definitions of "acturial method", "agreement", "closing costs", "conspicious", "credit", "earnings", "official fees", "goods", "services", "sale of services", "precomputed", "seller", "consumer lease", "revolving charge account", "cash price", "consumer loan", "amount financed", "loan", "lender", "loan finance charge", "supervised loan" and other definitions which protect the consumer by providing a universal framework for extensions of credit.

b) Provisions governing additional charges in credit sales, delinquency and default charges, rights to prepay, rebates upon prepayment, disclosure of method of calculating sales made by telephone, truthful advertising, limitations upon multiple agreements, balloon payments, attorney's fees, limitations on default charges, prohibitions against confessed judgments, home solicitation sales and changes in the terms of revolving loan accounts.

c) The area of credit related insurance remains untouched. Provisions include those governing: creditor's provision of and charge for insurance, excess amount of charge, conditions applying to insurance to be provided by creditor, unconscionability, maximum charge by creditor for insurance, amount of refund or credit required, existing insurance, choice of insurer, charge for insurance in connection with a deferral, refinancing, or consolidation, duplicate charges, term of insurance, amount of insurance, filing and approval of rates and forms, property insurance, insurance on creditors interest only, liability insurance and cancellation by creditor.

d) The UCCC's important provisions governing remedies and penalties are also untouched. These include such vital limitations on creditor remedies such as restrictions on deficiency judgments in consumer credit sales, no garnishment before judgment, limitation on garnishment no discharge from employment for garnishment, extortionate extensions of credit and unconscionability.

e) Additionally, debtor remedies are provided including civil liability for violation of disclosure provisions, debtor's right to rescind certain transactions, refunds and penalties as set-off to obligations, as well as criminal penalties for willful violations and disclosure violations.

Even this exhaustive statute is augmented by separate statutes in the various UCCC states governing such topics as discrimination in credit granting and state truth-in-lending disclosure requirements.

2. Deregulation in Illinois and Consumer Protections

While the majority of states have not enacted the UCCC, similar comprehensive statutes exist in all states. Illinois, which deregulated interest rates in 1981, left all of its consumer protections untouched. The provisions in the Consumer Finance Act, Insurance Premium Financing Act, Retail Installment Sales Act, Motor Vehicle Retail Installment Sales Act, Motor Vehicle Retail Installment Sales Act and Illinois National Association of Insurance Commissioners (NAIC) Act remain in place. Among these protections which are found in the relevant statutes are:

assignments
attorney's fees
balance due, recovery
cancellation
charges (additional, default, deferral, delinquency)
classifications
collection
consumer transactions
contract prohibitions
contract requirements
credit cards
credit discrimination
credit insurance
cross-collateral
default
default charges
deferral charges
deficiency recovery
definitions
delinquency charges
disclosure (advertising, general, loans, mail transactions, open-end credit, sales, telephone sales)
election of remedies
equal credit opportunity
finance charges
garnishment of consumer
home repairs
home solicitation sales
insurance conditions
insurance financing
insurance rates
insurance terms
interest
leases, general
liabilities, civil
liability insurance
licensing
loan requirements
mail transactions
motor vehicle sales
notices
open-end credit
optional provisions
penalties (civil, criminal)
premium financing
prepayment
property insurance
real estate transactions
rebates
redemption
referral sales
refinancing
regulated loans
release, termination
repossession
revolving credit
sale requirements
satisfaction
security interests
setoff
settlement
supervised loans
telephone transactions
termination
violations, recovery
waiver

3. Deregulation and Common Law

Although many basic consumer protections are found in statutes regulating financial services companies, basic common law principles of law and equity remain untouched by rate deregulation. Such principles include the traditional contract defenses including capacity to contract, fraud, misrepresentation, duress, coercion, mistake and other invalidating causes.

Additionally, those provisions of the Uniform Commercial Code (UCC) which govern consumer transactions remain unaffected by rate deregulation. The UCC is law in 49 states with Louisiana's Napoleonic Code containing similar provisions.

4. Deregulation and Loan Sharking

Although opponents of deregulation raise the specter of loan sharking as a result of deregulation, S. 730 does not affect the Consumer Credit Protection Act of 1968, which currently proscribes that activity by imposing substantial penalties of up to $10,000 in fines and/or twenty years in prison for those in violation. If a particular state's loan sharking statute is affected in any way, an easy solution is the implementation of an extortionate credit statute which would prevent the collection of debt by the use of force or coercion.

Further, a state could simply pass a law requiring that any extender of consumer credit be licensed regardless of the rate charged, thereby bringing that lender within the penumbra of all consumer protection statutes.

D. State Legislative Relief Is Often Subject To Sunset Limitations

Rate regulation lags behind the financial marketplace. In 21 states, temporary rate relief is provided by statutes subject to a sunset provision, thereby deferring painful legislative reevaluation of interest rates to a later date. This on again-off again legislation makes long-term strategic planning difficult for financial services companies. In the following states credit laws are subject to such sunsets:

Alabama:	Interest rate preemption over $5,000, until July 1, 1987.
California:	a) Installment sales (goods) - $11 per $100 per year, until October 1, 1984. b) Revolving sales - 1.6% per mo. on first $3,000, until October 1, 1984 (eff. 1/1/83). c) Revolving sales - 1.6% on first $3,000 until 1/1/84. d) Consumer Finance Lenders Law - until January 1, 1984, 5% fee (max. $50) on loans to $2,500 and variable rate based FRB discount rate to $10,000. e) California Industrials - variable rates and fee until January 1, 1985.
Connecticut:	a) 21% per year installment sales, until October 1, 1983. b) Revolving sale and loan rates - 1-1/2% per mo., until October 1, 1983. c) Motor vehicle sales rates - 18 - 19-1/4 - 21-1/2% per year, until October 1, 1983. d) 18% per year insurance premium financing, until March 1, 1983.
Hawaii:	a) Industrial loan and sales finance installment rates, until July 1, 1985. b) Open-end credit and credit card rates, until July 1, 1985.
Kansas:	U3C: alternate 21% per year for financial institutions and sales, until July 1, 1983.

Louisiana:	Motor vehicle rates - 24, 30, 33%, until September 30, 1984.
Maine:	Home repair sales - 18% per year, until May 7, 1983.
Maryland:	a) Motor vehicle sales rates - 21.5% - 23.5% - 27% per year, until August 1, 1982. b) Small Loan Law - 33%, 24% ¶ $1,000 to $2,000; 24% over $2,000 (until July 1, 1985). c) Second Mortgage Act - 24% plus 2% fee (max. $250), until July 1, 1985. d) Sales Finance - 24% per year from July 1, 1982 to July 1, 1985.
Michigan:	a) Second Mortgage Loan Act: 18% per year to 12/31/83. b) Bank installment loan rate (16.5%) for motor vehicle sales and motor vehicle sales rates - 16.5% - 19% - 22% per year, until December 31, 1983. c) Home Improvement Sales: alternate rate permitted until December 31, 1983.
Minnesota:	a) First home mortgage rate preemption, until August 1, 1984. b) New motor vehicle and mobile home rates, until July 31, 1983.
Mississippi:	a) Consumer finance dollar adjustments, until June 30, 1984. b) 7% per year add-on for installment loans, until June 30, 1984. c) 12% per year add-on for bank installment loans, until June 30, 1984. d) Revolving sale and loan rates - 1-3/4% per mo., until June 30, 1984. e) Alternate 5% over FRB discount rate for motor vehicle and mobile home sales and usury law, until June 30, 1984.
Montana:	a) Regulated lenders (not consumer finance licensees) - rate preemption, until July 1, 1983. b) Sales finance rate preemption, until July 1, 1983.
Nebraska:	Consumer Finance Act: 24% to $1,000, 23% over, until September 30, 1985.
New Mexico:	Rate preemption, until July 1, 1983.

New York:	Rate preemption and small loan ceiling increase and second mortgage authority, until June 30, 1983.
North Carolina:	Small loan rates - 3% per month to $600, 1-1/4% per month to $3,000, until July 1, 1983.
Ohio:	Alternate 25% for loans and sales until January 1, 1985.
Pennsylvania:	18% for installment and revolving sales until March 29, 1985.
Tennessee:	$11.75 add-on for installment sales and 21% per year for revolving sales from July 1, 1982 to July 1, 1983.
Utah:	U3C: 21% per year alternate (by rule), until 60 days after end of 1983 legislative session.
Wisconsin:	Rate deregulation from November 1, 1984 to October 31, 1987.

E. Restrictive Ceilings and Capitalization

Financial services companies, like other financial institutions, acquire the funds of others to relend. Unlike other financial institutions, only a minor percentage of these liabilities are deposits; virtually all funds are purchased on the market from the public or from other financial institutions. Finance company liabilities in 1980, as set forth in the following Federal Reserve Board table may be classified as follows:

40.5%	short term debt (due in less than one year)
34.5%	long term debt (due in one year or more)
10.5%	mixed liabilities, e.g., deposits, thrift certificates, and dealer reserves
14.5%	stockholder equity
100.0%	Total Liabilities and Capital

The 1980 Federal Reserve Board study of finance company liabilities and capital outstanding reflected:

Type of liability	Amount outstanding					Percentage of total liabilities & capital	
	Millions of dollars			Percentage change			
	Mid-1970	Mid-1975	Mid-1980	1970-75	1975-80	Mid-1975	Mid-1980
Bank loans	7,551	8,617	15,458	14.1	79.4	9.7	8.8
Short-term	6,581	7,900	7,885	20.0	-0.2	8.9	4.5
Long-term	969	718	7,573	-25.9	954.7	0.8	4.3
Commercial paper	22,073	25,905	52,328	17.4	102.0	29.2	29.9
Directly placed	19,247	23,686	43,232	23.1	82.5	26.7	24.7
Dealer placed	2,826	2,218	9,095	-21.5	310.1	2.5	5.2
Other short-term debt	975	2,815	10,627	188.7	277.5	3.2	6.1
Other long-term debt	15,501	29,013	52,898	87.2	82.3	32.7	30.2
All other liabilities	4,531	8,416	18,363	85.7	118.2	9.5	10.5
Capital and surplus	9,947	13,951	25,350	40.3	81.7	15.7	14.5
Total liabilities and capital	60,577	88,716	175,025	46.5	97.3	100.0	100.0
Memo:							
Short-term debt	29,629	36,620	70,840	23.6	93.4	41.3	40.5
Long-term debt	16,470	29,730	60,471	80.5	103.4	33.5	34.5
Total debt	46,100	66,350	131,311	43.9	97.9	74.8	75.0

(Source: FRB Survey of Finance Companies, 1980)

With 40-50% of their liabilities in money market (short term) borrowings or equivalent, it is apparent that finance company cost of funds must reflect current money market conditions. If this cost cannot be recovered in turn from the finance company borrowers - because of restrictive state rate ceilings - then return on invested capital becomes unsatisfactory (less than would be provided in a market regulated environment) or, at the extreme, nonexistent. Credit is denied, and some creditors go out of business or divert capital to more productive endeavors.

The estimated cost of borrowing for finance companies reflects the pressure money costs exert on smaller independent finance companies. Many of those companies are dependent upon rediscounting companies at rates of 4% or more over the prime rate. The following chart indicates the extremes of money costs to finance companies:

OVERALL COST OF FUNDS, MEDIANS, MAXIMUMS AND MINIMUMS
BY SIZE OF COMPANY, 1979 - 1981

(In percent)

	1980			1981		
	Med.	Max.	Min.	Med.	Max.	Min.
Companies with Consumer Credit Outstanding of:						
Over $500 million	10.93	14.24	9.84	14.00	15.25	10.44
$150-500 million	10.50	12.16	8.90	13.71	16.41	11.60
$50-150 million	12.21	15.07	10.50	15.04	18.40	12.33
Under $50 million	13.45	20.18	6.50	14.00	21.33	6.56
TOTAL	12.40	20.18	6.50	14.09	21.33	6.56

(Source: AFSA survey of member companies.)

F. Usury Ceilings and the Finance Industry Market

The violatility of money costs impacts all segments of the financial services industry markets. Although state statutes permit rates of charge up to 36% annually on the very smallest loans, Federal Reserve Board data reveal that finance companies charged an overall rate of 23.1% on loans made in 1982.

The three major segments of our industry; small loans, second mortgage and sales finance are often hampered by restrictive ceilings. When the market rate for funds exceeds a restrictive usury ceiling, a lender must make a strategic decision which often results in the marginal borrower being denied credit.

FINANCE RATES, MATURITIES, AND AVERAGE AMOUNT
FINANCED BY FINANCE COMPANIES, SELECTED YEARS, 1977-1982

	1977	1978	1979	1980	1981	1982
Average Finance Rates*						
Personal loans	20.5%	20.5%	20.5%	21.1%	21.7%	23.1%
Automobiles						
New	13.1%	13.1%	13.5%	14.8%	15.9%	15.8%
Used	17.6%	17.6%	18.0%	19.1%	20.0%	20.8%
Mobile homes	13.6%	13.4%	13.6%	15.5%	18.1%	18.8%
Other consumer goods	19.2%	19.0%	19.1%	20.6%	21.6%	22.6%
Average Maturities*						
Personal loans in months	42.9	45.8	50.5	63.8	71.1	67.2
Automobiles - percent						
New - Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
% over 42 months	26.4	45.3	59.2	68.3	74.9	81.6
% 37 to 42 months	21.2	16.9	11.0	7.4	4.5	2.4
% 31 to 36 months	40.4	27.3	21.1	16.9	13.9	10.8
% 30 months or less	11.9	10.5	8.7	7.4	6.6	5.2
% balloon	--	--	--	--	--	--
Used - Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
% over 36 months	8.7	21.9	40.8	49.0	57.5	65.5
% 31 to 36 months	57.3	43.5	43.5	36.4	31.4	24.7
% 25 to 30 months	23.6	19.7	8.5	6.3	4.1	3.3
% 24 months or less	10.4	14.9	7.2	8.3	7.1	6.6
% balloon	--	--	--	--	--	--
Mobile homes	126.9	130.8	133.4	137.2	154.1	155.6
Other consumer goods	23.6	25.8	25.4	24.5	28.7	30.4
Average Amount Financed*						
Personal loans	$1,521	$1,572	$ 1,684	$ 1,975	$ 2,574	$ 2,683
Automobiles						
New	$4,990	$5,590	$ 6,035	$ 6,316	$ 7,313	$ 8,173
Used	$2,720	$3,168	$ 3,555	$ 3,807	$ 4,354	$ 4,744
Mobile homes	$9,174	$9,999	$11,617	$12,807	$14,625	$14,364
Other consumer goods	$ 563	$ 605	$ 600	$ 624	$ 833	$ 990

Source: Federal Reserve Board
Note: Parts may not add to totals due to rounding.

* Unweighted means of periodic sample data for each year. Average amount financed excludes precomputed finance charges.

III. CONCLUSION

AFSA supports the deregulation of all interest rate ceilings and urges federal preemption of restrictive state usury rates. We thank this Committee for the opportunity to make our views known on this vital issue.

APPENDIX

Posted Prime Rate Since 1933

1933	October	1.50%
1948	January	1.75
	August	2.00
1950	September	2.25
1951	January	2.50
	October	2.75
	December	3.00
1953	April	3.25
1954	March	3.00
1955	August	3.25
	October	3.50
1956	April	3.75
	August	4.00
1957	August	4.50
1958	January	4.00
	April	3.50
	September	4.00
1959	May	4.50
	September	5.00
1960	August	4.50
1965	December	5.00
1966	March	5.50
	June	5.75
	August	6.00
1967	January	5.75
	March	5.50
	November	6.00
1968	April	6.50
	September	6.25
	December	6.50
	December	6.75
1969	January	7.00%
	March	7.50
	June	8.50
1970	March	8.00
	September	7.50
	November	7.25
	November	7.00
	December	6.75
1971	January	6.50
	January	6.25
	January	6.00
	February	5.75
	March	5.50
	March	5.25
	April	5.50
	July	6.00
	October	5.75
	November	5.50
	December	5.25
1972	January	5.00
	February	4.75
	March	5.00
	June	5.25
	August	5.50
	October	5.75
1973	January	6.00
	February	6.25
	March	6.50
	April	6.75
	May	7.00
1974	January	8.75
	March	12.00
	December	10.50
1975	March	7.75
	June	7.00
	December	7.25
1976	June	6.75%
	December	6.25
1977	September	7.00
	December	7.75
1978	June	9.00
	September	10.00
	December	11.25
1979	June	11.50
	December	15.25
1980	April 2	20.00
	May 2	18.50
	May 30	14.50
	June 6	13.00
	July 4	12.00
	July 18	11.50
	August 1	10.75
	August 15	11.00
	September 5	11.50
	September 19	12.50
	October 3	13.50
	October 17	14.00
	November 7	15.50
	November 21	17.00
	December 5	19.00
	December 12	20.00
	December 19	21.50
1981	January 9	20.00
	February 6	19.50
	March 6	18.50
	April 3	17.00
	April 21	17.50
	April 30	18.00
	May 4	19.00
	May 11	19.50
	May 18	20.00
	May 22	20.50
1981	June 2	20.00
	June 15	19.50
	June 22	20.00
	July 8	20.50
	September 15	20.00
	September 22	19.50
	October 6	19.00
	October 13	18.00
	November 2	17.50
	November 9	17.00
	November 16	16.50
	December 1	15.75
1982	February 1	16.50
	February 17	17.00
	February 23	16.50
	May 26	16.00
	June 24	16.50
	July 20	16.00
	July 28	15.50
	August 2	15.00
	August 16	14.50
	August 18	14.00
	August 23	13.50
	October 7	13.00
	October 13	12.00
	November 22	11.50
1983	January 11	11.00
	February 25	10.5

The **Chairman**. Thank you very much. Were all of you or some of you at the hearings this morning?

I'd like each of you to respond to a question, because as I think you saw, I was frustrated by the last panel. This has been going on for years when both Mr. Schechter and Miss Broadman have been before the committee. They are very sincere, hard-working people and there is no doubt in my mind that they believe exactly what they say.

Nevertheless, that gives me problems because when I strip out the politics of some of these consumer issues, I usually come to the conclusion that most of my colleagues would not be taking the positions they are, except that they don't want to be branded anticonsumer, antienvironment or whatever.

However, the question I want to ask is: Are any of you going to start charging 50 or 80 percent if you take off the usury ceilings? Am I the one that's wrong, or is it true that businesses have to continue to do business and be competitive or they're not going to have the business anymore?

I remember years ago in Salt Lake City we had a leasing company that was just scooping everybody. It turned out the reason was that they were dishonest and cheating. They lasted for a couple of years and it didn't take any law to put them out of business. People started to find out that their advertising was false, and so on. It didn't take very long till they just didn't have any customers anymore. Apparently, the basic difference of opinion here is that consumer groups don't trust the marketplace at all and they believe there is no market discipline.

I can't imagine running a bank, savings and loan, finance company, or anything else for very long and charging unconscionable interest rates.

Now, we have had unconscionable interest rates by everybody the last couple of years, but not through design. But that's getting back into that issue of who's at fault for the general economic condition.

Isn't there a market discipline out there? Am I wrong?

Mr. **Barr**. Absolutely, you're correct, Mr. Chairman. I have data here that I'll submit to the committee from the credit union movement for the year ending 1982. The reason I'm not going to give it to you now is I think it could be put in a more understandable format.

[Information follows:]

CUNA

Credit Union National Association, Inc.

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JAMES C. BARR, CAE
EXECUTIVE VICE-PRESIDENT & DIRECTOR
GOVERNMENTAL AFFAIRS DIVISION

May 4, 1983

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
SD-534
United States Senate
Washington, D.C. 20510

Dear Chairman Garn:

I am now able to supply you with information you requested from me during the April 12, 1983 hearing on S. 730, The Credit Deregulation and Availability Act of 1983.

Please find included two tables on the most recent trends in credit union loan rates and an explanation of those tables.

Sincerely,

James C. Barr
James C. Barr, CAE

Enclosures

JCB/CRN:emw

TABLE 1

CREDIT UNION LOAN YIELDS
1980 - 1982

1980	11.18%
1981	12.65%
1982(p)	13.53%

(p) This is a preliminary estimate based on 358 Custom Research credit unions.

TABLE 2

CREDIT UNION LOAN RATES
1981 - 1982
(% of respondents)

	AUTO LOANS						
	LT 12%	12%	12-15%	15%	15-18%	18%	GT 18%
Highest Rate '81	1.36	21.68	8.83	40.90	11.73	13.19	2.30
Rate 12/31/81	1.39	22.01	9.50	41.36	12.34	11.85	1.56
Highest Rate '82	0.94	13.74	8.95	40.86	16.84	16.03	2.64
Rate 12/31/82	1.45	17.01	17.34	41.29	12.72	9.41	0.79

	PERSONAL LOANS						
	LT 12%	12%	12-15%	15%	15-18%	18%	GT 18%
Highest Rate '81	0.86	20.27	5.30	38.33	8.38	21.11	5.36
Rate 12/31/81	0.67	20.34	5.51	38.37	9.14	21.20	4.53
Highest Rate '82	0.82	13.08	4.91	35.96	9.94	27.46	7.91
Rate 12/31/82	0.69	13.86	6.63	36.71	11.59	25.19	5.34

EXPLANATION OF TABLES

With the "deregulation" of credit union share accounts - both in terms of rate and type - coupled with raising interest rate ceilings and a relatively high level of market interest rates, we would have expected credit union loan rates to rise.

This, in fact, is what occurred. The data in Table 1 indicate that the yield on the credit union loan portfolio rose from 11.18% in 1980 to an estimated 13.50% in 1982. These figures, of course, represent aggregate data for the entire year in question and do not deal with the question of rates charged by individual credit unions.

Data on loan rates charged by individual credit unions are not available for the early years under consideration. However, on the 1981 and 1982 CUNA Annual Survey, respondents were asked to indicate both the highest rate charged during the year and the rate charged at year end for auto loans and personal loans.

Based upon the path of market interest rates during 1981 and 1982 and the continued transition of the credit union share portfolio to more interest-sensitive sources of funds, we estimate that the cost of funds climbed throughout 1981 and on to mid-1982 (approximately September) before declining at year end. In this environment, we would expect that loan rates would have risen in 1982 from their peak levels of 1981 and then declined by the end of 1982.

The data found in 1982 support this contention. From these figures, we see that 27.22% of respondents were charging a rate in excess of 15% for auto loans at their high point in 1981. At some point in 1982, 35.51% of respondents were charging a rate in excess of 15% with the number declining to 22.94% by year end. For personal loans, we find a similar pattern. At the high point in 1981, 34.85% of respondents were charging a rate in excess of 15%, with the number rising to 45.31% at the high point in 1982 and then declining to 42.12% by year end.

The data indicate a wide divergence in the loan rates charged by individual credit unions, the primary reason for the difference resulting from the differing composition of the share portfolio and thus the cost of funds. However, as we look at the data we find that even at the peak level of market interest rates in 1981 and 1982:

1) no more than 2.64% of respondents charged an auto rate in excess of 18%; and

2) no more than 7.91% of respondents charged personal loan rates in excess of 18%. [1]

These figures suggest that credit unions responded to several considerations when determining loan rates during 1981-82, conditions including:

1) cost of funds,
2) competition,
3) the need for a risk premium to compensate for increased interest rate volatility, and
4) the desire to provide members with relatively low-rate loans.

However, as the data indicate, it was primarily market forces that caused loan rates to rise and fall and that having interest rate ceilings at 21% did not lead to credit unions moving to precipitously raise rates to take advantage of members.

---

[1] Respondents to the Annual Survey tend to overrepresent large asset size credit unions. Since the data indicate, as expected, that these credit unions tend to charge higher loan rates (as a result of their more competitive savings programs) the results here overestimate the percent of total credit unions that would be charging rates in excess of 15% or 18%. For example, 7.91% of respondents had a high rate in excess of 18% for personal loans in 1982. If we would weight the sample to the distribution of credit unions, we would estimate that approximately 4.0% of all credit unions were charging this rate.

The **Chairman**. Plain language? [Laughter.]

Mr. **Barr**. Yes, sir, but Mr. Evans mentioned the subsidized car rate loans as an example, and banks and credit unions and other financiers have had to move to meet that competition.

CREDIT UNION RATES ARE TRADITIONALLY LOWER

Credit unions have historically charged under whatever their maximum permissible rate might be. We had a Federal usury statute, as I pointed out earlier, since 1934, and our State-chartered members have to comply with whatever State usury laws are there. And again, credit unions are traditionally under whatever the maximum is.

The **Chairman**. You didn't ever go up to the 12 percent maximum. It did not become a floor. It was a ceiling until you were forced by competition because of the general market conditions.

Mr. **Barr**. What happened in the latter part of the 1970's when interest rates just really skyrocketed and credit unions went out the 12-percent limit—basically, they went out of the lending business.

Loan demand was great, but it's difficult to loan money at 12 percent when your cost of funds are 14 and 15 percent.

When the usury ceiling was raised to 21, then credit unions did go to 14, 15 and, in some instances, 16 percent. But almost in no instance did they ever go to the 21 percent.

Historically, credit unions were at the 8-, 9-, 10-percent level, and at the end of the year provided their members with an interest rebate. This was common practice, as it is common practice in the cooperative movement, if you have profits at the end of the year, you return it to your members in the form of patronage refund.

What happens is they immediately move to the worst-case scenario. The marketplace is not perfect; it never has been, it never will be. I commend you and your colleagues in doing what you can do to make it a more perfect place, but we'll never make it absolutely perfect.

It does respond to competition.

Mr. **Butler**. I might comment on two points, one in support of the first issue. Our local newspaper in Philadelphia periodically publishes for consumer information a chart showing what everybody's charging or paying on deposits and loans. A couple of weeks ago they picked a 48-month new car loan. Now, the usury ceiling in Pennsylvania on that transaction is 18. There were 17 banks listed and the rate ranged from 12½ to 15½.

If usury ceilings were eliminated tomorrow, nobody would go to what we can now charge, let alone to some unconscionable rate. The other point that disturbs me some is that if we charge unconscionable rates, we put the consumer in the position where they can't repay the loan—perhaps we put them into bankruptcy or at least into default, and we don't make any money if we do that.

That simply isn't good business, to force the consumer into a situation where they can't repay the transaction.

We only make money if we lend it to them and get it back pretty much as agreed.

So, there are a variety of constraints in the market place, both competition and your own good business sense, that would prohibit unconscionability.

The CHAIRMAN. Any other comments. Mr. Dixon?

CONSUMER PROTECTION

Mr. DIXON. Just a couple, Mr. Chairman. This morning some of the consumer representatives kind of kept saying that if usury limits were lifted at the Federal level, that it would somehow have the effect of reducing consumer protections that are provided by the individual States.

Our reading of the bill says that that is not the case at all. Wisconsin is very unique in some of the consumer protections that we have, and our consumers would continue to have them even with preemption.

I just wanted to make that point.

The CHAIRMAN. I appreciate that because it's certainly not the intent of the Federal override of usury ceilings to get involved in the States consumer protection laws.

It's certainly not my intention and I do not read the bill that way at all. The testimony sounded to me like we were wiping out case law 10 miles long regarding consumer protection.

Well, it doesn't repeal Truth-in-Lending, truth in leasing, contract consumer protection, or anything else on a Federal or State level.

Mr. DIXON. The other point I wanted to make is that the consumer credit business is rapidly becoming nationwide, from the standpoint of competition in our market, the main credit business. For example in Wisconsin, we compete not only with other card programs in the State, but also with Citicorp and Chicago; we have Minneapolis banks, and banks from Nebraska, in short, our competition is nationwide. We would in my view not be in a position to arbitrarily increase rates from whatever it is, 18 percent or whatever, to some arbitrary figure.

The amount of competition for that business with deregulation is simply not going to permit that to happen. There's going to be too much competition for the consumer credit business.

MAXIMIZE CREDIT PROFITS

The CHAIRMAN. It's been my experience too that businesses will try and maximize their profits. If they don't, they shouldn't be in business and their stockholders aren't going to approve of them for very long.

But when you use that term and say you're going to maximize profits, that certainly has to have limits. You're obviously going to reach a point of diminishing returns where those profits will disappear very rapidly if your competitors are offering lower rates.

Even in the high interest rate environment we've experienced over the last 2 or 3 years, every financial institution that I've had anything to do with was trying to charge the lowest rate they possibly could. Even though it was a very high rate—the prime was at 21½ percent and I don't want to be misunderstood, I don't think that's a good rate—but my point is that within the framework of the overall economy, in order to keep a cash flow going, they were attempting to charge the lowest rate possible and still keep their heads above water. Particularly in the thrift industry. I know in my own State there were some savings and loans that simply made no mortgage loans at all for a period of 2½ years.

They didn't make any mortage loans. It wasn't a matter that they could have gone out and made loans at 17½ percent, 18 percent. They did not choose to do that at all.

Mr. McNEILL. Mr. Chairman, we have a saying in our shop that we can't make a profit by saying no. That means that we want to make the loans if at all possible. But, as you've alluded, if we price our customers out of the market where he can't make those monthly payments, doesn't want to make them and doesn't want to undertake that purchase, then we in effect have said no.

As I mentioned earlier, in November we got an amendment to the Constitution that permits up to 17 percent on consumer loans. But the rate on consumer loans that is prevalent in the area is 13 percent; so we didn't automatically go up to the maximum.

The marketplace, as one of the other panelists said, is not perfect, but it obviously is working thus far for us in Arkansas.

The CHAIRMAN. Mr. Barr, it's my understanding that the Credit Union National Association is on the board of the Consumer Federation of America?

Mr. BARR. That's correct, yes, sir.

The CHAIRMAN. Yet you have diametrically opposite positions on this issue?

Mr. BARR. On this particular issue we have agreed consistently to disagree, yes, sir. Historically they've been on one side and we've been on the other.

The CHAIRMAN. Don't they view you somewhat differently? At least credit unions are supposed to be owned and controlled by the depositors and are not supposed to be big profit organizations, such as savings and loans and banks.

Does your feeling move them at all, since you are depositor-owned institutions and are supposed to be co-op type of organizations, viewed as nonprofitmaking, consumer-oriented groups.

That's why I am so puzzled that we don't seem to be able to get through that there are some problems created by arbitrary laws, rules, and regulations.

Mr. BARR. The Consumer Federation of America, as you know, is a broad-based consumer organization consisting of a large number of various consumer groups.

I guess they could be properly termed an umbrella-type organization of the consumer movement. As consumer-owned cooperatives, credit unions have always supported that organization and worked within the organization to determine policy.

We have one person in our organization who sits on the board of directors. Unfortunately, as I stated a moment ago, we've not been able to convince them that this particular position they have is probably an erroneous one.

It's a very emotional thing with them, as you probably know, and they just historically believe that usury ceilings and interest rate controls are a good thing. And we've not been able to convince them otherwise.

RENT CONTROL LAWS

The **Chairman**. There are lots of differences of opinion you can have with people. You go back and restudy and rethink and say, "Well, I disagree, but I understand your position."

You look at rent control. It's the same sort of thing. Rent control should be designed to help the poor, those who can't afford housing as nice as you and me. Yet, in virtually every city in the country where you have rent control, what you find is less rental stock available. People quit building and the existing ones become unprofitable because they can't maintain and keep them up. So, you convert them to condominiums and then, the next step is to have a condominium conversion prohibition law.

I don't know, it's just puzzling.

I guess I shouldn't belabor the point, because I'm preaching to the choir in this case. But the sequence of events in arbitrary consumer protection laws, it seems to me, is that they are just hurting the very consumers they are intended to help.

Rent control laws have made less housing available to low-income people. I don't think there's any doubt about that. Usury ceilings in a high-interest-rate economy make less money available to lower-income people.

So, I ask the question—you're a consumer-oriented group and yet you don't have any more impact on them than I do. [Laughter.]

Mr. **Barr**. We believe, with them, that the key to a good consumer is a well-informed consumer. And we work with them a great deal in this area.

My own personal opinion is that the well-informed consumer generally has a choice. I think the example was given this morning of the department stores operating in Virginia that have recently moved from 18 percent on their credit cards to 21 point something percent.

Well, as a Virginia consumer, I am certainly aware of that. I will continue to purchase at those stores, but I will not allow my purchase to go over the period of time where they charge a service charge.

If it's necessary for me to finance that, I'll get a loan at a credit union or something like that or finance it under the 21-percent or whatever it is they're going to charge in Virginia.

I would hope that all well-informed consumers would do likewise. At least they have a choice.

The **Chairman**. I would agree with you that well-informed consumers are important. I don't think we have come very far in informing them very well, despite the intent of the Truth-in-Lending—truth in leasing—because those laws are so incomprehensible and so detailed. That's another disagreement that we constantly have—of how do we best serve that consumer. And I'm totally in favor of them being able to make an informed judgment.

But the Truth-in-Lending forms we still have, after some simplification, are not very effective disclosure. There's so much detail, so much complicated information in them, that I don't think we serve the consumer or inform him very well.

The initial intent of Truth-in-Lending, in my reading of the debates at the time, was to give them enough information so that they could comparison shop.

I'd hate to go around with those Truth-in-Lending forms to several institutions and, even from my perspective, as chairman of the Banking Committee, determine which one of them is giving me the best terms for my loan.

Mr. **Barr**. Truth-in-Lending was a great thing, and we supported it. It was a great idea. Unfortunately, the lawyers got hold of it and confused the matter a bit.

The **Chairman**. Would you suggest we have a law preempting lawyers? [Laughter.]

Mr. **Evans**. Mr. Chairman, one very practical issue has been referred to in my statement here, which I think does warrant further attention by the committee down the road.

We have not proposed anything to deal with it. But de facto deregulation of rates has really already been accomplished for the national banks because they can simply perch in Delaware or South Dakota and export that rate via credit card anywhere they want to. This was made possible, of course, under the Marquette National Bank decision, on which the Supreme Court upheld the right to export that rate if they were located in any State in the country back in 1978.

But by the same token, a retailer, in another case that went to the Supreme Court, was prohibited from doing the very same thing. They could be financing the very same merchandise, yet the State where the borrower resided was what controlled in that case.

So, we now have one system of financing by the national bank credit card route, where it's quite permissible to use whatever rate, you know, is allowed by the home State, and another system applicable only to the finance companies, retailers, and what have you that are not national banks, which says the rate allowed by the State where the borrower or the debtor resides must control.

I think, in a period of persistent continuing deregulation, this is something which must be addressed, regardless of whether or not the Congress acts further to deregulate interest rates across the board.

Essentially, this has happened for a very large and important part of our competitive marketplace, but not for the others.

NONBANK BANKS

It is forcing my members, for instance, to go buy banks and call them nonbank banks. You've heard of that, I think.

One of our members—associates in Dallas—had a bank card operation but could not, under existing rules, have it in their own company. They had to have a bank front for them, if you will. It was perfectly legitimate, but all the paper had to be assigned.

So, in their search for ownership and the bank to do this, they had to go acquire commercial banks to give out the commercial loans and become a nonbank bank. It worked very well, very quietly. Everybody else got the news of it, and we soon had this spate of filings.

But I think that's something which, regardless, cannot be permitted to be done. It's working distortions in the regulatory marketplace, if you will. People are seeking to become licensed banks simply because they need it that way to compete with Citibank, for instance. You've got to admire it, because they have set up a system of nationwide financing.

As reported this week, you can be in a Washington bank and go to a San Francisco teller in a parking lot and get money 3,000 miles away.

I think all of our competing financial institutions should at least be on that basis.

It's quite a problem.

The CHAIRMAN. I understand the problem, believe me. I have the world's largest network of informers, unpaid, all volunteers. There's nothing that happens that somebody feels is unfavorable to them that I am not made aware of. [Laughter.]

I knew about South Dakota before South Dakota knew about South Dakota, and the same with Delaware.

Mr. EVANS. I just want to be the last in line of complainers.

The CHAIRMAN. The CIA would love to have a network like I have, and the FBI. It's incredible. And they all do their work for nothing, no charges at all.

Well, one of the reasons I asked the question—if you were all here this morning, I won't take your time to belabor and rehash what you heard then, but I would ask you if any of you have any more comments you would like to make in closing? [No response.]

Thank you very much. We appreciate your coming and sharing your time with us.

The committee is adjourned.

[Whereupon, at 3:15 p.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

The Report of the

Interagency Task Force on Thrift Institutions

Submitted at the direction of the Depository Institutions Deregulation and Monetary Control Act of 1980

Department of the Treasury
June 30, 1980

THE REPORT OF THE
INTERAGENCY TASK FORCE ON THRIFT INSTITUTIONS

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Chapter II

Expanded Nonmortgage Investment and Statutory Limits on Consumer Credit Finance Rates*

Potential solutions to the asset-liability mismatch problems of thrift institutions have been the subject of considerable study and debate, as well as the topic of Presidential and Congressional reports. These studies generally have concluded that at least a partial solution lies in affording thrifts broader asset powers designed to allow the industry to match more closely asset and liability maturities and, hopefully, the cost of funds with the yield on the loan and investment portfolio. The move toward broadened asset powers, however, has been constrained by the conviction that, to ensure an "adequate and stable" flow of funds to finance the nation's housing stock, the thrift industry should continue to be a dominant permanent holder of mortgages.

The legislative and regulatory response to these problems first concentrated on an attempt to control the cost of funds to thrift institutions (Regulation Q-type interest rate ceilings), and then to develop secondary markets for certain types of mortgages, to increase the availability of a wider variety of deposit instruments to thrifts and, more recently, to authorize the issuance of mortgages with some of the attributes of short-term assets. At the state level, there has been a trend towards a more liberal set of asset acquisition powers primarily for mutual savings banks (MSBs), but also for state chartered savings and loan associations (S&Ls).

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* Prepared primarily by staff at the Federal Deposit Insurance Corporation, the Department of the Treasury, and the Office of the Comptroller of the Currency.

The most recent action in the direction of liberalizing thrift powers at the federal level was the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221). ("the Act"). As related to liberalized asset powers, the Act pertains only to federally chartered MSBs and S&Ls. Specifically, federal thrifts are authorized to grant consumer loans, acquire commercial paper and corporate debt securities up to an aggregate limit of 20 percent of assets; provide overdraft privileges for NOW accounts and issue credit cards as a means of providing consumer credit; additionally, federally chartered MSBs are authorized to place up to 5 percent of assets in business loans (and to provide transactions account services to these loan customers), provided that the loans are to businesses within state or within 75 miles of the bank's main office.

These provisions represent a significant increase in asset acquisition powers available to federally chartered S&Ls, and to the state chartered associations which achieve equivalent authority by means of liberalization of state restrictions or through charter conversion. In the past, savings and loan associations generally have been rigidly constrained to mortgage, home improvement and, in some cases, student and construction loans. 1/

1/ There are exceptions to this statement. For example, the state of Rhode Island permits thrifts (including S&Ls) to own a commercial bank which, in practice makes its parent institution almost indistinguishable from a full service bank.

Mutual savings banks, on the other hand, traditionally have enjoyed broader investment and loan powers than have S&Ls. A majority of the 17 states that charter MSBs allow these institutions considerable latitude with respect to direct consumer lending powers, and all of these states allow participation in this and other markets by means of the authority to acquire various forms of corporate debt securities. Additionally, many of the MSB states have permitted mutual savings banks to make direct loans to commercial enterprises.

Although MSBs are structurally different from savings and loan associations, the best evidence available regarding the response of the thrift industry to the expanded asset powers offered by P.L. 96-221 lies in an analysis of the current behavior of mutual savings banks. Therefore, this chapter first will briefly consider the implications of the Act for asset-type diversification on the part of thrift institutions, primarily based upon the actions of the MSB industry. Secondly, the chapter will present an analysis of the probable impact of statutory limits on consumer finance rates which would tend to reduce thrifts' entrance into the consumer credit field.

A. Expanded Asset Powers*

As indicated above, the mutual savings bank industry is probably the best available laboratory in which to assess the most likely response of thrift institutions to broadened options for asset acquisition alternatives. The present discussion will focus on the two broad asset areas that have received the most attention and that would move the asset powers of thrifts more in line with those currently available to commercial banks -- i.e., direct consumer and business lending powers. Indirect lending powers -- e.g., the purchase of corporate securities -- also are briefly considered.

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* Prepared primarily by staff at the Federal Deposit Insurance Corporation.

Consumer Credit

Virtually all of the 17 states in which MSBs operate permit these institutions to engage in some form of direct consumer credit extensions other than real estate related loans. 1/ This authority exists because of a specific statutory provision, a "prudent man" or leeway investment provision, or by virtue of ownership of a commercial bank subsidiary. The specific powers to engage in direct consumer lending available among the states vary widely with respect both to loan type and permissible volume.

In general, the current portfolio structure of MSBs does not indicate that the industry has shifted into direct consumer loans to any significant extent; as of year-end 1979, the industry (FDIC insured) held approximately 4 percent of the total loan portfolio in direct consumer loans. Even in the New England states, which traditionally have granted MSBs, reasonably broad consumer lending

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1/ Pennsylvania and Delaware restrict MSB consumer lending to education loans, whereas New York also allows overdraft loans. Until recent amendments to the state statute, Alaska restricted the lending powers of MSBs to loans for real estate related purposes.

and transactions account authority, the banks (FDIC insured) held only slightly in excess of 6 percent of total loans in direct consumer loans. 1/ While there are probably numerous reasons for this seeming lack of interest in such loans, perhaps the most important include the costs associated with gaining expertise in evaluating and administering these loans, and, on the demand side, the inability of many MSBs to offer "full service banking" services to the consumer sector. Additionally, federal income tax laws -- which provide a substantial incentive to maintain at least the minimum percentage of assets in "qualifying" assets -- and other state restrictions may have contributed significantly to the observed behavior.

While participation in the consumer lending market may involve some start-up costs and, thus, may not directly contribute immediately to profits, such lending would still benefit thrifts by improving their ability to compete with other types of financial institutions. Consumer lending as a service -- combined with NOW account powers -- would enhance the appeal of thrifts as household financial "service centers" and this could provide increased stability to deposits. Thus, the availability of broader consumer lending powers may result in an increase in the share of the deposit market held by the thrift industry as a result of its ability to offer "one-stop" banking services for the household sector. Prior

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1/ This figure does not include the assets of affiliated commercial banks in Rhode Island and New Hampshire.

to the enactment of P.L. 96-221, many thrifts operated at a competitive disadvantage vis-à-vis commercial banks in this regard.

Business Credit

Approximately one-half of the mutual savings bank states have permitted MSBs to engage in some form of business lending, although none of these states has permitted these banks to offer transactions accounts to profit-seeking enterprises. 1/ On an industry basis (FDIC insured), MSBs devoted approximately one-half of one percent of total loans to commercial and industrial loans.

It is obvious that mutual savings banks have not penetrated the business loan market to any meaningful extent; even in those states that have afforded MSBs the most liberal of business lending powers, savings banks apparently have not made any significant inroad into this market. The same type of reasons given for a minimal penetration of MSBs in the consumer credit markets probably accounts for the apparent lack of interest in business loans, while the ability of savings banks to offer complementary services necessary to maintain a meaningful business relationship may account for the seeming lack of demand for those services.

The extension of significant business lending powers (coupled with expanded liability powers and other powers necessary to develop meaningful wholesale arrangements) would probably require a significant commitment of personnel and expenditure of financial

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1/ Maine recently amended the state statute to offer state chartered MSBs the same business transactions account powers available to federal MSBs under P.L. 96-221.

resources to acquire the necessary expertise in this area; moreover, there would be some difficulty encountered in acquiring a profitable market share from the already firmly entrenched commercial bank industry. For these reasons, it is doubtful that, even if given the appropriate powers, there would be a rapid shift of the institutions into the business loan market. If it occurred, this shift would most likely take place over a considerable period of time.

However, this is not to argue that the thrift industry should be prevented from participating in business loan markets. There are segments of this market in which the institutions may be able to compete (e.g., small business loans). Additionally, loan participations with commercial banks may provide a means for many thrift institutions to gain immediate expertise in business credit evaluation and commercial loan servicing.

Summary

The current evidence gained from the MSB industry would indicate that the thrifts in general will not move rapidly to take advantage of the asset powers offered under P.L. 96-221. However, this evidence should not be viewed as conclusive; there are reasons to believe that the present MSB portfolio structure may not be representative of future actions on the part of thrift institutions. These mitigating factors are as follow:

-- The structure of financial institutions has been subjected to sufficient shocks within recent years (especially during the recent periods of historically high interest rates) to warrant a significant change in institutional behavior patterns.

- The experience of mutual savings banks has been limited to a small number of political jurisdictions and heavily concentrated in the Northeastern United States. To the extent that the liberalized powers become available to all thrifts regardless of chartering authority, different market and political environments may lead to increased innovation on the part of the industry.

- Expanded nonasset powers -- including transactions account and credit card authority -- may enable thrift institutions to compete more effectively with the commercial banking industry for consumer and perhaps certain forms of business deposit and loan accounts.

Nevertheless, the available evidence does indicate that thrifts will not immediately shift into non-real estate loans; any shift, that might occur would probably be completed only after a considerable period of time. From a historical point of view, mutual savings banks apparently have viewed mortgages and debt securities (both Treasury and corporate) as the significant investment options, dealing only marginally in the direct consumer and business loan markets. However, as pointed out above, thrift institutions may be dealing in a new environment where past behavior is a poor predictor of future actions.

In addition, the asset liberalization features of P.L. 96-221 pertain only to federally chartered thrifts; to the extent that states do not liberalize asset powers in line with the federal standards, some state chartered institutions would be operating at a competitive disadvantage. However, pressures placed on the state legislatures or regulatory agencies by the threat of massive charter conversions may result in parity with respect to asset acquisition powers and other restrictions. This tendency has already been manifested in Maine and Alaska with the relaxation of restrictive state statutes and in efforts in other states to liberalize state laws in line with the guidelines set by federal statutes.

Indirect Investment Opportunities

The discussion above indicates that thrifts may be able to engage in nonmortgage consumer and business lending only with a considerable lag -- as the institutions overcome significant start-up costs and gain the necessary expertise to compete efficiently in these new areas. However, thrifts need no new marketing shifts to begin purchasing corporate debt, including commercial paper. In effect, rather than gain expertise in originating and servicing new types of loans (*e.g.*, consumer loans), thrifts can *lend* to the specialists in these areas (*e.g.*, can purchase the commercial paper of consumer finance companies and thereby participate in the consumer loan market).

Commercial paper potentially is of significant importance as a thrift asset because it yields a fairly high return and is of very short duration. Therefore, it is useful as a source of liquidity which yields a higher return than other liquid assets. Of course, smaller thrift institutions could not easily diversify away default risk of commercial paper, because such paper generally is sold in large denominations. However, smaller institutions could minimize default risk by only purchasing the paper of the largest, strongest U.S. businesses.

B. Eliminating Statutory Limits on Consumer Credit Finance Rates*

Thrifts may have little incentive to diversify into consumer lending as long as state restrictions on finance rates make such lending unprofitable. The problems generally caused by usury limits are not new but have been more evident recently as market interest rates rose above these ceilings. As the cost of funds rises but usury ceilings restrict the permissible finance rate that may be charged, lending institutions channel funds into other types of loans or other geographic markets.

Removal of these ceilings would improve the ability of consumer loan specialists (e.g., finance companies) to originate such loans, thus improving the profitability and reducing the risk of thrifts' lendings to such institutions. And any improvement in the functioning of the consumer lending market could enhance the ability of thrifts to participate directly in this area. This could improve thrifts' ability to compete with other financial intermediaries for consumer deposits as well as improve thrifts' earnings through their participation in the consumer credit area.

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* Prepared primarily by staff at the Department of the Treasury and the Office of the Comptroller of the Currency.

In an attempt to accommodate recent financial realities Congress already has moved to preempt some state laws and allow certain lending rates to be determined competitively. Federal statute now permanently removes all state-imposed interest rate ceilings on first lien mortgage loans, subject to state reversal of the preemption within three years, and establishes a three-year override of state usury limits on business and agricultural loans of $25,000 or more (again, subject to a state override). Moreover, all federally insured depository institutions may charge an interest rate equal to 1 percent above the Federal Reserve discount rate on all other loans (including consumer loans) where state law imposes a lower limit. However, this latter provision, in those states where there is no higher permissible rate, may still set interest rates on consumer lending well below market levels.

Background

Although usury ceilings may exert a restraint on potentially monopolistic practices in some markets, evidence collected over several years appears to indicate that, on balance, the elimination of restrictive usury limits would be in the public interest, benefitting borrowers as well as lenders. 1/ However, in moving toward the elimination of lending rate limits, it is important that unwary borrowers be protected from unscrupulous lenders. This is a major reason that usury laws have persisted -- to protect the consumer when disclosure requirements are not a sufficient safeguard. In those

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1/ For further discussion, see Harold C. Nathan, "Economic Analysis of Usury Laws", Journal of Bank Research; Winter 1980, pp. 200-210.

parts of the country where credit markets are not yet reasonably competitive, a need to safeguard the interests of those more vulnerable may exist.

Where market rates exceed usury ceilings, lower-income and higher-risk borrowers generally have been unable to obtain loans from thrift institutions, commercial banks, or other lenders, and credit has flowed to markets (both product and geographic) not subject to usury ceilings. Restrictive interest rate limitations close off conventional credit sources to many borrowers. When lenders are unable to charge rates sufficient to yield a market rate of return, they generally lend only to their most preferred borrowers. Further, because the cost of making small loans may exceed permissible finance charges, credit may be shut off to small borrowers, whether good or bad credit risks. Borrowers have the option of foregoing credit, availing themselves of credit sources where loans are available above usury rate limits (*e.g.*, out-of-state lenders or even loan sharks), seeking other unregulated sources of credit such as family or friends, or purchasing goods from retailers who can adjust prices to offset costs of providing credit services. Thus, the existence of a ceiling may offer only limited protection from usurious practices. In states where the law restricts both interest rates and loan size, the number of loans may be higher, but low-income, high-risk customers still find it difficult, if not impossible, to obtain credit. Instead, even low-risk customers often are forced to "double-up" by acquiring costly multiple loans to get the amount of credit they desire. These conclusions have been documented in several studies of consumer finance companies, commercial banks, and mutual savings banks. Studies of new automobile, mortgage, and personal loan markets reach similar conclusions. The findings consistently indicate that some lower-income consumers are denied access to conventional credit when market rates exceed statutory ceilings.

The presence of usury ceilings generally may have a depressive effect on the economies of states with binding ceilings. Because credit is an essential ingredient to commerce, restrictions that limit its availability also tend to dampen economic growth. For example, one study shows that the economy of Tennessee, a state which until 1978 was burdened with a constitutional interest cap of 10 percent, grew faster than the national economy except when market interest rates rose above the state usury ceilings. At that point, the economy of that state slowed substantially. The same study calculated that between 1974-76, the annual loss in production averaged $150 million, the annual loss of jobs averaged 7,000, the annual loss of retail sales averaged $80 million, and the annual loss of assets in financial intermediaries averaged $1.25 billion.

A similar slowdown occurred in Missouri from early 1973 to early 1974 when the mortgage rate ceiling was a rigid 6 percent. New mortgage loans at Missouri savings and loan associations declined 37 percent, compared to a 6 percent decline in neighboring states.

Because lending practices are regulated by each state, variations in usury rates also distort the geographic distribution of credit and commerce. Arkansas, which has a 10 percent constitutional usury limit, offers a striking example. In the Texarkana region, there are distinct differences between the types of firms located on the Texas side of the city and those on the Arkansas side of the city. There is considerably less retail trade on the Arkansas side despite the approximately equal distribution of population between the states. The majority of automobile dealers, appliance stores, furniture stores, and other businesses that rely on consumer credit has moved to the Texas side of the city.

Usury laws not only differ from state to state, but they differ, as well, from lender to lender. Most states differentiate among maximum rates permitted on various classes of loans made by various financial institutions. National banks, which operate under the federal usury statute (12 U.S.C. 85), are a notable anomaly in this respect. Ostensibly, they are subject to state limits. However, federal case law has developed the "most favored lender" rule. Under this rule national banks may charge not only the rate fixed generally by state law, but also any rate established for special transactions or special classes of lenders. Although the usury relief provisions of the Depository Institutions Deregulation and Monetary Control Act may ultimately be interpreted to extend such treatment to all federally insured lenders, the extensive legislative and judicial history of the federal statute suggests a continuation of the current limited advantage of national banks.

Legal restrictions that inhibit credit flows are becoming less effective as the free market successfully circumvents them. At the same time, this circumvention imposes a certain cost on society as the market finds a less efficient way of doing what it has been told not to do. The impact on local communities, individuals and businesses can be quite severe. For example, Citicorp has announced its intention to move its massive credit card operations from New York to South Dakota. This impending drain on jobs and business in New York is directly attributable to the difference between consumer lending laws currently in force in the two states.

Finally, there is a side-effect of usury ceilings that has little to do directly with consumer lending. Specifically, such ceilings may hinder institutions' ability to attract funds through newly developed types of liabilities. The popular six-month $10,000 "loophole" certificate of deposit is an example of an instrument whose availability may be severely reduced as a result of usury ceilings. Typically, a financial institution accepts an amount less than $10,000 from the depositor, lending the difference at one percent or more above the interest rate carried by the certificate. For example, suppose the certificate rate is 12 percent and the loan rate 13 percent. A depositor could combine a $5,000 deposit with a $5,000 loan at 13 percent and thereby earn a net return of 11 percent on the $5,000 deposit. But where the state usury ceiling stands at 12 percent (currently the situation in at least nine states) the institution would be forced to lower the $10,000 certificate rate to 11 percent or less, thus reducing MMC attractiveness to any depositor with or without the full $10,000 to invest. With overall profitability diminished by law, an institution might have no choice but to abandon use of the "loophole" certificate to the ultimate detriment of the small saver.

Benefit for Thrift Institutions

In the current environment, the existence of usury ceilings frustrates the expansion of thrift institution asset powers intended under the Depository Institutions Deregulation and Monetary Control Act. In states where ceilings on consumer loan charges are unrealistically low, little incentive exists for portfolio diversification along these lines through originating or holding consumer loans.

The benefits of expanded asset/liability powers for thrift institutions are discussed elsewhere in this study. However, it is important to note here that in the presence of binding ceilings, thrifts may not be able to overcome the high costs of making small loans to consumers, even low-risk consumers.

Finally, removal of usury ceilings should enhance the ability of thrift institutions to participate in the consumer lending area indirectly by improving the ability of all financial intermediaries to make consumer loans. Thus, liberalization of consumer lending reductions should make more profitable and less risky thrifts' lending to consumer loan specialists (e.g., finance companies) through purchases of consumer loans originated by these institutions or through purchases of their commercial paper. That is, thrifts do not have to become specialists in consumer lending in order to benefit from a preemption of usury ceilings and in order to diversify out of mortgages.

Credit Unions

Federal credit unions face a separate federal statutory limit on the interest rate that they may charge on loans. During 1979, the ceiling was 12 percent on all loans, which produced two effects. First, as interest rates began to rise, credit unions found themselves unable to pay competitive rates on savings accounts. Large amounts of savings outflows occurred after each major dividend period, resulting in a substantially reduced savings growth of 2.4 percent for the year. This was the slowest annual rate of growth on record and reduced the credit union share of the consumer savings market from 4.9 percent at year-end 1978 to 4.7 percent at year-end 1979. Then, as interest rates continued to rise and remained high, credit unions curtailed lending in favor of investing in government securities and other assets yielding a higher return. Growth in federal credit union loans outstanding plummeted to 3.7 percent in 1979 from 22.3 percent in 1978 -- the slowest rate of growth since World War II. This slow growth of loans and savings in 1979 persisted into 1980. However, the Depository Institutions Deregulation and Monetary Control Act of 1980 raised the permissible interest rate ceiling on credit union loans to 15 percent. Further, it permits the National Credit Union Administration to increase the rate, for periods not to exceed 18 months, after consultation with the appropriate committees of the Congress, the Treasury Department and federal depository institution regulatory agencies. This authority should alleviate the difficulties for credit unions.

Conclusion

Permitting thrift institutions to offer a wide variety of credit potentially increases the options available to borrowers, This in itself should reduce the need for usury ceilings as a protection for consumers against monopolistic lending practices. At the same time, consumer lending undertaken by thrifts could provide increased cash flow and, after start-up costs are covered, more flexible earnings for thrifts, thus strengthening their long-run ability to provide mortgage-origination services and to attract deposits as a source of funds as well.

Removal of usury ceilings would not result in exorbitant interest rates for consumer lending if competitive markets exist. Of course, consumer lending rates have remained high relative to the cost of other types of borrowing because the cost of consumer lending is higher than, say, the cost of providing longer-term business loans. Thus, the current level of consumer finance rates and its consistency across lenders are not evidence of a monopolistic market, but rather constitute the market rate of interest associated with such lending. Nevertheless, should there be continued concern over protection for consumers from clearly monopolistic practices, then a substantial raising of permissible rates might be preferable to a complete elimination of ceilings. That is, usury ceilings could be set at levels that are not binding, for purposes of the operation of competitive markets, but that would reduce the occurrence of usurious lending practices.

The Mortgage Corporation
Federal Home Loan Mortgage Corporation
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Kenneth J. Thygerson
President
Chief Executive Officer
(202) 789-4720

April 11, 1983

The Honorable Jake Garn
SD 534 Senate Dirksen Building
Washington, D.C. 20510

Dear Senator Garn:

I am writing to express my support for S. 730, the "Credit Deregulation and Availability Act of 1983." This legislation would remove all interest rate ceilings under state law that apply to business, agricultural and consumer credit. The legislation would, in effect, extend the same relief from state usury laws for agriculture, business and consumer loans as the Depository Institutions Deregulation Act of 1980 extended to home mortgage credit.

Freddie Mac has a keen interest in this legislation, since restrictive usury ceilings in a number of states over the years have limited lenders' ability to participate in the corporation's Home Improvement Loan (HIL) program. The corporation testified in support of similar legislation before the Senate Banking Subcommittee on Housing and Urban Affairs in 1981. Freddie Mac has an even greater interest in this legislation today, since we soon hope to initiate a program to purchase secured "equity" junior lien mortgages. As you may know, legislation to provide this authority to the corporation has been included as part of the House housing bill, H.R. 1. It is my hope that the Senate will take similar action in the near future by including this authority in the Senate housing bill.

Freddie Mac was established by Congress in 1970 to establish and promote a secondary market for conventional mortgage loans. During the past twelve years, the corporation has committed to purchase over $72 billion in mortgages and committed to sell over $61 billion in conventional mortgaged-backed securities. Congress authorized Freddie Mac to purchase energy conservation and home improvement loans in December 1978.

Under the HIL program, a lender is able to make home improvement and energy conservation loans and sell to the corporation participation interests from 50% to 95% as well as whole loans. With the proceeds from the sale, the lender can originate other home improvement loans. A summary of our home improvement loan program features is attached. Active participation in our program will enable lending institutions to make further contributions to local efforts to promote home rehabilitation, neighborhood revitalization, and energy conservation activities. Following passage of legislation to provide Freddie Mac purchase authority for secured junior lien loan authority, the corporation will be able to provide an increased supply of funds to homebuyers who wish to draw on the equity of their home for a variety of purposes.

The effect of S. 730 is perhaps best illustrated by the effect of previous usury preemption bills. The Depository Institutions Deregulation and Monetary Control Act of 1980 provided a federal preemption of state usury laws applying to first mortgages. In addition, the Act allowed federally-insured depository institutions to originate loans other than first mortgages at rates which do not exceed the greater of either the state usury ceiling or one percent above the discount rate. Unfortunately, this option did not provide meaningful relief for secured and unsecured consumer loans.

Two years ago, Freddie Mac conducted a survey of state laws to determine the effect of state usury ceilings on lender's ability to participate in our HIL program. In thirty-one states, the usury ceiling was either at or below the rate which lenders must charge to participate in the corporation's HIL program, in order to make a profit and cover their adminstrative costs. Although rates are lower these days, there is no guarantee that this problem won't arise again given the historic cyclical nature of interest rates.

The federal preemption for first lien mortgage credit has increased the supply of mortgage funds available in many states which previously had restrictive usury ceilings. You may recall that for the greater part of 1979, lenders in twenty-two states were unable to originate first lien home mortgages at rates which would cover their costs and be competitive in the national secondary mortgage market. This situation was remedied by the 1980 federal preemption for mortgage credit. Consumer protection problems which were raised prior to passage of the 1980 Act did not occur. Rates did not rise out of line with current market rates prevailing across the country. Competition among lenders held rates at levels consistent with rates generally prevailing across the country.

Expansion of the usury preemption provisions to include junior lien loans will ensure access to our home improvement loan program for lenders in all states just as the federal preemption for mortgages broadened participation in our mortgage programs. Also, S. 730 preserves consumer protection provided under state law and gives states the right to reject the federal preemption at any time within three years of the date of enactment.

The corporation strongly urges passage of S. 730. I would be happy to respond in more detail to any questions you may have surrounding this issue. I appreciate your interest in the problems associated with restrictive state usury ceilings and the effect of these ceilings on the availability of the corporation's programs.

Sincerely,

Kenneth J. Thygerson

The Effects of Usury Ceilings:
The Economic Evidence

by
Donna Craig Vandenbrink

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Executive Summary

Usury regulations recently have been the subject of intense debate which has culminated in a spate of legislative reforms. Advocates of usury laws argue that they protect borrowers from lenders who would otherwise charge exorbitant interest rates and engage in abusive lending practices; critics of ceilings argue that they force lenders to restrict credit availability and create other market distortions. This paper examines the economics of usury ceilings in order to identify the substance of the arguments on both sides of this debate. The paper links each argument to economic theory and reviews empirical evidence on the various predicted effects of usury ceilings.

Theoretically, a usury ceiling is a form of price control; it establishes a legal maximum interest rate (or price) which can be charged for a loan or an extension of credit. When the statutory ceiling rate is below the rate of charge that would be established in an unregulated market, the ceiling bars lenders from legally charging any higher price. When this situation occurs, the usury ceiling is said to be binding or effective. Thus, usury ceilings can protect some borrowers from paying what they may view as exceedingly high rates of interest in order to obtain credit.

However, at the same time that binding usury ceilings may benefit borrowers by maintaining lower interest charges, they are also likely to restrict the supply of credit available to borrowers. When binding ceilings prevent lenders from adjusting interest charges to cover their costs of providing loans, they will instead adjust the amount of credit they are willing to extend to insure that costs are met at the maximum rate of interest legally allowed.

Empirical studies of U.S. credit markets have found that:

> *Credit is less readily available when usury ceilings become binding. Studies of bank loans, mortgage loans, and consumer credit have all supported this theoretical prediction. Binding usury ceilings present consumers with a trade-off between lower interest rates and reduced credit availability.
>
> *Usury ceilings encourage lenders to adopt other credit rationing practices and strategies unfavorable to borrowers. These include more stringent terms and shorter maturities on mortgage loans, larger minimum sizes for personal loans, and higher fees for checking accounts and mortgage appraisal.
>
> *Certain borrowers, notably low income and high risk borrowers, are more likely to feel the brunt of the reduction in credit availability when usury ceilings are binding.
>
> *Usury laws have additional adverse economic impacts because of the fact that in the United States not all forms of credit are subject to the same statutory treatment. The lack of uniformity distorts the flow of credit among credit-sensitive economic activities and among states. Differences in usury ceilings have been found to be responsible for disproportionate cutbacks in mortgage credit and housing activity in some states, and for the loss of jobs and tax revenues to other states.

The generally negative economic impact of usury ceilings might be an acceptable alternative to borrowers suffering "exorbitant" interest rates without the protection of the ceilings. In theory, however, unregulated interest rates will not be unreasonable (in the sense that they are not out of line with lenders' costs) when credit markets are sufficiently competitive. It is difficult to determine from empirical studies of consumer credit markets how rigorous competition actually is. However, some competitive pressure does seem to exist. Moreover, there is some evidence that usury ceilings themselves are partly to blame for weakening the competitive environment in credit markets.

Consumers' market awareness can also be a significant counterbalance to lenders' power to arbitrarily set interest charges. Truth-in-lending legislation has been linked with a steady increase in levels of consumer awareness of interest charges over the last decade, suggesting that such legislation may be an effective alternative to achieve the goals of usury ceilings.

The weight of the economic evidence on usury ceilings generally supports the current legislative trend toward relaxation of interest rate controls. The question remains whether deregulation of usury ceilings should be left to individual states or whether it is best accomplished by federal preemption. From an economic point of view, federal preemption would allow markets to work more efficiently by treating all states uniformly. However, this benefit needs to be weighed against the political implications of the federal government entering an area which has traditionally been under the jurisdiction of the states.

I. Introduction

Regulations against usury have been debated from the time of Moses. Today, as a result of a prolonged period of high inflation, record interest rates, and sluggish economic growth, usury ceilings are once again a controversial subject. Issuers of credit and operators of credit-sensitive businesses have called for the deregulation of interest charges. They argue that interest rate ceilings work to consumers' disadvantage by restricting credit flows and distorting financial markets. On the other hand, consumer advocates claim that elimination or easing of usury laws will lead to abusive lending practices and will force individuals to pay exorbitant interest rates to obtain loans. Less strident supporters of usury ceilings believe they are necessary to protect borrowers, particularly small borrowers, and to enable them to obtain funds at reasonable rates. Who is correct? Are the critics of usury ceilings simply speaking out of their own self-interest? Do usury ceilings operate in the best interests of consumers?

Recent legislative action has favored the critics of usury ceilings by relaxing interest rate controls. The 1980 Depository Institutions Deregulation and Monetary Control Act overrode state interest ceilings on some categories of loans, and Congress is now considering new legislation to further preempt state limits on interest charges. At the same time, many state legislatures have revised their usury statutes. Some states have raised their limits, others have eliminated restrictions, and still others are considering revisions. In large part, these recent changes in usury regulation have been in response to the current economic situation. But is deregulation of usury ceilings desirable? And if it is desirable, should it be left to the states or is it best accomplished by federal preemption?

Economists have accumulated a considerable body of research which bears on these questions. This paper surveys the economic evidence on the subject of usury ceilings with the purpose of providing a basis for evaluating the arguments raised in the public debate. The first three sections of the paper deal with the economic effects of usury ceilings, and the fourth section examines the likely economic consequences of removing statutory limits on interest charges. A final section considers policy options. The empirical research reviewed in this paper concerns primarily, but not exclusively, the consumer credit market, since this is where usury ceilings have drawn the most attention. In many states, in fact, loans to corporations are not subject to the interest rate restrictions imposed by usury laws.

II. Usury Ceilings in a Competitive Market

Two issues have figured prominently in the current debate over usury laws. They are the effect of interest rate ceilings on the price of credit and their effect on the amount of credit available. Participants in the debate emphasize one effect or the other. Both sides of the argument have a basis in theory. This section develops the theoretical model of the impact of usury ceilings on the price and availability of credit and cites empirical research to substantiate the theoretical claims.

In theory, the credit market can be viewed much like any other economic market.[1] There are buyers (borrowers) and sellers (lenders) of credit; the price of credit is the interest rate. The credit market is easily represented in a conventional supply and demand diagram like Figure 1. The demand curve represents the amount of credit borrowers desire at various prices (interest rates). The supply curve reflects lenders' cost of funds and thus the amount of credit they are willing to grant at various interest rates, assuming the market is competitive. According to theory, borrowers and lenders will eventually establish an equilibrium in the market at a price which just balances the supply and demand for credit. We can call this price the normal market rate of interest. Such a rate is shown as r_m in Figure 1.

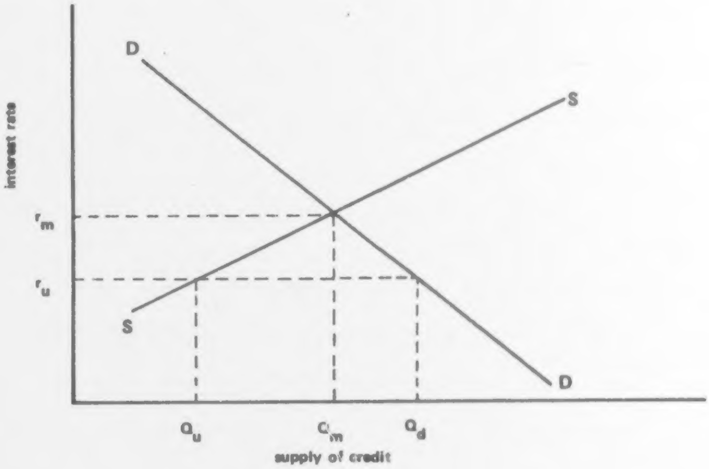

Figure 1

Usury laws stipulate a maximum rate of interest which lenders may legally charge.[2] When a usury law is introduced it may alter the way in which both price and quantity are determined in the credit market. Exactly what happens depends on the level of the usury ceiling with respect to the market rate. When the legal ceiling is above the market rate of interest (r_m), the law has no effect at all. The market forces of supply and demand are unconstrained by the usury ceiling, and the equilibrium price and quantity of credit are unchanged. However, when the legal ceiling is below r_m, the regulation does affect the market outcome. Such a usury ceiling, like the rate r_u in Figure 1, is said to be binding or effective.[3] A binding ceiling obviously alters the price of credit--the ceiling rate becomes the rate of interest charged. Therefore, if the market rate r_m had been considered too high, a usury ceiling of r_u, for example, would have succeeded in lowering the rate of interest for borrowers.

Establishing a lower-than-market interest rate by means of a usury ceiling will also bring about a decrease in the quantity of credit. Given lenders' costs (the supply curve), the most credit which they can provide when the interest rate is held down to r_u is Q_u. Therefore, the binding usury ceiling will lead to a reduction from Q_m to Q_u in the amount of credit available to borrowers. Furthermore, in contrast to the situation in the unregulated market, this amount of credit will not satisfy all those who want to borrow at the ceiling price. The usury ceiling creates a situation of excess demand with borrowers seeking Q_d in credit. Borrowers cannot bid up the price in order to obtain more credit because of the rate ceiling, and lenders will not provide any more credit at the legal maximum interest rate. Thus, at the legal ceiling price there is a greater demand for credit than supply.

The important implication from this economic model is that usury laws can succeed in holding interest rates below their market levels only at the expense of reducing the supply of credit to borrowers.[4] Thus, there exists a trade-off between interest rates favorable to borrowers and credit supplies favorable to borrowers. Empirical research on the effect of usury ceilings in the United States indicates that such a trade-off does exist.

The Effect of Usury Ceilings on Credit Availability: The Evidence

A study by Robert Keleher of the Federal Reserve Bank of Atlanta [9] looked at how loan extensions by banks in Tennessee varied as market interest rates fluctuated above the state's 10-percent usury ceiling. In regressions controlling for other factors which reduce loan extensions as market interest rates rise, Keleher found that the further market interest rates rose above the state usury ceiling (i.e., the more binding the ceiling), the smaller was the weekly change in total loans outstanding.[5] This relationship was true of all large reporting banks in the state as well as for most subcategories of bank loans.[6] Keleher's study of bank commercial credit provides support for the hypothesis that binding usury ceilings restrict the supply of credit.

A number of studies of mortgage markets also lend support to this argument. The Federal Reserve Bank of Minneapolis [3, 20] analyzed Minnesota's experience with an 8-percent usury ceiling on conventional home mortgages. As is the case in many other states, Minnesota exempts FHA and VA mortgages from the state rate ceiling. The Minneapolis study found that when market rates climbed to between 9 and 10 percent in 1973-74, home financing in Minnesota shifted substantially from conventional mortgages--which were subject to the ceiling--to exempt FHA or VA loans. During the period when ceiling rates were binding on conventional mortgages, the share of total mortgage financing in FHA/VA loans rose in Minnesota from 22 to 25 percent. In contrast, the FHA/VA share steadily declined in states that had no binding rate ceilings. About 40 percent of all new mortgage loans issued in the Twin Cities at this time were FHA-insured, almost double the usual share. This substitution indicates that conventional mortgage credit became decidedly less available when interest rates on these loans were constrained by the ceiling.[7]

In a more statistically controlled analysis, James Ostas [16] examined mortgage market data for 15 large SMSAs over the period 1965 to 1970. He indirectly evaluated the impact of usury ceilings on mortgage lending by relating differences in usury ceiling rates among SMSAs to differences in the number of housing permits issued. Using regression analysis Ostas found a strong negative relation between housing permits and the spread between estimated market mortgage rates and usury ceilings. At a minimum, his estimates showed an 11 percent reduction in permit authorizations for every one percentage point that the usury ceiling was below the market rate.[8] Ostas reasoned that the reduction in housing permits came about because binding usury ceilings initially reduced mortgage loan volume. Earlier, Philip Robins [19] had obtained similar results from a study of residential construction activity in 77 SMSAs in 1970. Robins found that, controlling for other intercity differences, housing starts were 28 percent lower in SMSAs where usury ceilings were binding. He also estimated that a usury limit one percentage point below the market rate was associated with a 16 percent lower level of single-family housing construction. These findings again suggest that binding ceilings lead to a reduction in mortgage credit, which in turn results in fewer housing starts.

In yet another study, James McNulty [12] analyzed the impact of usury ceilings on mortgage lending directly and separately from their impact on housing construction. He followed a time-series approach, utilizing data on mortgage markets in Georgia for the period 1965 to 1977. McNulty's regressions showed that the Georgia usury ceiling (which ranged from 8 to 10 percent during the period studied) had a restrictive effect on single-family lending activity by savings and loans in Georgia, despite the fact that market interest rates generally were below the state ceiling for most of the period studied. (Market rates were substantially above the ceiling for only four quarters.) This result substantiated McNulty's claim that usury ceilings can have an impact on lending activity even before average market rates hit the ceiling, since there is a fairly wide distribution of actual mortgage market rates. McNulty estimated that as the market rate approached the ceiling, mortgage lending was lowered 7.5 to 12.5 percent for each one percentage point difference between ceiling and market rates.[9]

The effect of usury ceilings on the supply of consumer credit has been examined in several other studies. In a technical study for the National Commission on Consumer Finance, Robert Shay [21] examined data on personal consumer loans collected in a survey of 48 states in 1971. Shay's study showed a small, but statistically significant, relationship between rate ceilings and loan extensions, controlling for market concentration and several other factors. Specifically, Shay found that, across states, each one percentage point decrease in the usury ceiling on small loans was associated with 18 fewer loans per 10,000 families. (The average number of loans per 10,000 families was about 1,300.) He also found that the dollar volume of loan extensions fell as ceilings were lowered, but this relationship was not statistically significant.[10] These results indicate that the supply of personal loans is smaller where rate ceilings are lower. Shay also found that lower rate ceilings were associated with fewer new auto loans, but he did not find any significant effect on the supply of credit to purchase other consumer goods (mobile homes, boats, aircraft, and recreational vehicles).

A more recent study of the effect of usury ceilings on consumer credit produced some results which initially appear to contradict the theory. Richard Peterson of the Credit Research Center at Purdue University [17] compared urban consumer credit markets in Arkansas, which had a 10-percent comprehensive usury ceiling, with similar credit markets in Illinois, Wisconsin, and Louisiana, which had less restrictive ceilings. He found that, contrary to expectation, residents of Arkansas held as much (or more) credit overall as consumers in the other states studied. However, he also found that consumers in Arkansas held significantly less cash credit, and more point-of-sale credit (retail credit and credit cards) than their counterparts in the states with less restrictive ceilings.[11] Point-of-sale credit may be less affected by usury ceilings than cash lending because merchants and dealers who issue point-of-sale credit can raise prices on goods they sell to compensate for the costs of their credit operations.[12]

Another study under the auspices of the Consumer Credit Research Center also documented the effect of usury ceilings on the availability of consumer credit. Robert Johnson and A. Charlene Sullivan [8] examined the effect of a 1977 regulatory change in Massachusetts which lowered the maximum rate of charge on small loans (under $2,000 and 24 months). One finding of the study was that, as anticipated, the gross amount of regulated loans (under $3,000) outstanding in the state fell by 12.5 percent between 1975 and 1979.

III. Noninterest Credit Conditions: Usury Ceilings and Credit Rationing

Taken together, the results of the studies described above largely substantiate the argument that binding usury ceilings lead to a reduction in the amount of credit provided by lenders. But credit transactions involve a number of terms other than the interest rate. Usury ceilings may determine the "price" that lenders can charge, but they do not constrain the other conditions that lenders may choose to offer. Faced with a binding usury ceiling lenders may be expected to alter these noninterest conditions in order to achieve a higher effective return on the smaller amount of credit they will offer. Changes in the noninterest terms of credit transactions could be unfavorable to borrowers generally and could concentrate the restrictive impact of usury ceilings on certain categories of borrowers.

As pointed out earlier, under binding usury ceilings, borrowers demand more credit than lenders are willing to provide. In this situation, lenders may allocate credit among borrowers according to their own conditions. Lenders could, for example, differentiate eligible borrowers by raising down payment requirements, by offering shorter loan maturities (which raises amortization payments), and by raising minimum loan size requirements. Any of these actions would tend to reduce expensive default and collection costs while preserving lenders' overall profitability from a smaller quantity of credit extensions.[13] Lenders might also base credit extensions on certain desirable borrower characteristics. It is well known that characteristics like income, amount of assets, and length of relationship to the lender are associated with differing levels of risk that an individual borrower might default. Given a single interest rate ceiling, lenders are unable to alter interest charges in accordance with the riskiness of each loan. Therefore, they may instead reduce risk and preserve profitability by screening potential borrowers according to these risk-related characteristics.

Lenders have other, more direct options for preserving their profitability. When interest charges are constrained by usury ceilings, lenders may still utilize noninterest fees and charges as sources of revenue. The specific form these may take depends on the type of creditor.[14] For example, mortgage lenders may increase closing fees and prepayment premiums; credit-card issuers may institute annual fees or transactions charges; commercial banks may initiate charges for services previously provided gratis. Retailers who extend sales credit may even raise prices on all of their merchandise to cover the costs of their credit operations.

By employing these devices lenders may be able to skirt the impact of usury ceilings on their own revenues. More important, however, are the consequences which changes in noninterest loan conditions have on borrowers. Lenders' use of these devices tends to concentrate the impact of usury ceiling on certain borrowers. Making loan terms more stringent reallocates credit away from those who are unable to afford larger down payments or the larger installment amounts necessitated by shorter maturities and higher minimum loan balances. Determining credit-worthiness according to individual characteristics rations credit away from high-risk consumers who might be willing to pay higher-than-ceiling rates. Finally, adding noninterest charges eliminates from the market those for whom these extra costs are too great.

As a result of these lending practices, usury ceilings may fail to provide consumers with the protection and benefits which the ceilings were intended to provide. For example, usury laws may work against the goal of ensuring that credit is available to small, inexperienced borrowers. When lenders ration credit by some means other than price, small borrowers, low-income borrowers, and high-risk borrowers are likely to find it more difficult to obtain credit. Prime borrowers, on the other hand, may even obtain more credit than they would have at normal market interest rates. Furthermore, when lenders institute noninterest charges to compensate for interest rate ceilings, they effectively raise the cost of credit for the successful borrower. This means that while a ceiling may reduce the explicit price of credit (the interest rate), it may not result in lower overall costs of borrowing for those able to obtain loans. The noninterest charges also make it more complicated for customers to comprehend the total cost of borrowing and make it more difficult to make well-informed credit decisions.

These lending practices and their undesirable consequences may exist in the absence of interest rate ceilings. However, empirical studies have frequently found that the extent to which these devices are used is directly associated with the restrictiveness of usury laws. In other words, these studies indicate that usury ceilings create a climate in which lenders are likely to more vigorously pursue practices unfavorable to some or all borrowers.

Several studies have shown that loan terms definitely become less favorable to borrowers when usury ceilings become more restrictive. For example, the Minneapolis Federal Reserve Bank [3, 20] found that during one period when Minnesota's ceiling on mortgage loans was binding, the average maturity of conventional mortgages in the Minneapolis-St. Paul SMSA fell significantly. While maturities in the Twin Cities had been about three to four years shorter than in SMSAs without usury ceilings, the difference increased to seven years when the ceiling became restrictive. The same study found that required down payments increased much more sharply in the Twin Cities during this period than in the SMSAs not subject to binding usury ceilings. Similarly, a study by Kohn et al. for the New York State Banking Department [10] found that down payment requirements increased and maximum maturities decreased during the 1974 credit crunch when market interest rates rose above New York's 8.5 percent ceiling on mortgage loans.

Dwight Phaup and John Hinton's analysis [18] provided quantitative estimates of the impact of usury ceilings on noninterest loans in the mortgage market. Phaup and Hinton used the difference between a proxy market rate and the state usury ceiling as an independent variable in regressions explaining changes in three types of noninterest charges and terms--mortgage fees and charges, loan-to-value ratios, and maturities. The regressions were run on quarterly data on new mortgage lending for single-family dwellings in Schenectady, New York for 1961 through 1976. Since mortgage fees and charges were explicitly covered by New York's usury law, it was expected that mortgage lenders would not respond to binding usury ceilings by increasing these fees; this was indeed found to be the case. Other mortgage terms, on the other hand, were found to become more stringent as usury ceilings became more binding. Phaup and Hinton found that for each 1 percentage point the market rate rose abov the ceiling, there was a 4 percent reduction in mortgage maturities an an 8 percent decline in loan-to-value ratios.[15]

The Peterson study [17] described earlier examined noninterest credit conditions on various types of consumer credit. The study found that auto loans in Arkansas had shorter maturities than in states with less restrictive usury laws. In addition, the average minimum size for personal loans at commercial banks and credit unions was 2.5 times larger in Arkansas than in other states covered by the study. Peterson found that Arkansas lenders charged higher fees for mortgage credit investigations and appraisal than did lenders in other states with less restrictive interest rate ceilings. Arkansas residents also paid higher charges for checking accounts and overdrafts. (Moreover, retailers faced bigger discounts and less desirable terms when selling their retail credit contracts to other creditors.)

A number of empirical studies have demonstrated a direct relationship between the availability of credit to certain categories of borrowers and the restrictiveness of usury ceilings. Peterson, for example, found that cash credit was significantly less available to low-income and high-risk borrowers in Arkansas than in the other states studied. The lowest income group and the three highest risk groups of Arkansas consumers held a larger proportion of their credit from point-of-sale sources. These categories of borrowers were more likely to be denied cash credit in Arkansas than in other states in the study with less restrictive interest rate ceilings.

In their study of the Schenectady, New York mortgage market, Phaup and Hinton [16] were primarily concerned with the uneven distributional effects of usury laws. Therefore, in addition to presenting estimates of the effect of binding usury ceilings on mortgage terms and charges and evidence of the overall restrictive effect of these rationing devices on the number of new mortgages, they examined the hypothesis that lower income areas felt the impact of decreased mortgage lending activity more than other areas. In order to test this hypothesis they stratified census tracts by four different measures of economic status--mean income, percent of families above the poverty line, percent of owner-occupied housing, and mean value of housing--and ran regressions to explain the number of new loans for each census-tract stratum. They found mortgage activity was more sensitive to the usury ceiling and to noninterest credit terms in census tracts in the lowest stratum of each economic measure than in the higher strata, and these differences were almost always statistically significant. Thus, Phaup and Hinton provided a direct statistical confirmation of the uneven burden of usury ceilings on one group of potential borrowers.

Using the survey data collected by the National Commission on Consumer Finance, Douglas Greer [7] analyzed personal loan rejection rates by finance companies in 48 states in 1971. Greer found that differences in state usury ceilings alone accounted for over 50 percent of the variation in rejection rates among the states. Additional regressions showed an inverse relationship between rate ceilings and rejection rates which was strongest among low-ceiling states. Greer concluded from this study that the higher the rates they are permitted to charge, the more willing lenders are to accept risky borrowers. Consequently, binding ceilings make it more difficult for higher risk borrowers to obtain credit.

Finally, using the same data from the National Commission on Consumer Finance Robert Shay [21] found further indication that high-risk borrowers are the ones most affected by usury ceilings. Shay found that lower rate ceilings were associated with reduced credit availability in both the new auto and personal loan markets. Along with banks, auto dealers are the primary lending institutions in the auto credit market and finance companies in the personal loan market. Auto dealers (as retail installment lenders) and finance companies generally are subject to higher usury ceilings than banks because they deal with higher risk clientele. It was these higher rate ceilings, and not the ceilings on bank loans, which Shay found to influence credit extensions for auto and personal loans. He concluded that the reduced credit availability associated with usury ceilings falls on those whose credit standing is weakest.

Usury ceilings emerge from the analysis in this and the previous section as a regulatory policy with very mixed benefits for borrowers. The primary benefit is a lower-than-market interest rate. But, depending on lenders' actions, borrowers may end up facing higher noninterest credit charges as a result of usury ceilings. Moreover the lower-interest benefit of usury ceilings has attached to it a direct cost for the borrowing public in a reduced supply of credit. Furthermore the cost of restricted credit availability likely falls disproportionately on high-risk, low-income borrowers, those whom usury ceilings are often designed to protect.

IV. The Broader Impacts of Usury Ceilings

The impacts of usury ceilings identified so far have been ones affecting individual borrowers. Usury ceilings also affect consumers and the economy in a more general way. This macroeconomic impact is bound up in the particular way interest rate regulation has been implemented in the United States.

Diversity of Usury Ceilings

Responsibility for regulating interest rates on credit has, since colonial times, rested with the states. Most states have general usury laws which establish two ceilings: the contract rate, which is the maximum rate which may be agreed to in contracts, and the legal rate, which is the maximum rate which can be charged when a rate is not specified in a contract. Many consumer credit transactions, however, are exempted from these general usury statutes and are subject instead to special usury statutes.[16] These special statutes apply to specific types of lenders and specific types of credit, often with different limits depending on the size of the loan.[17] As a result, there is great diversity in the coverage of interest rate ceilings within individual states.[18] Furthermore, there is also great diversity in ceiling rates and coverage across states.

These legal arrangements have important implications for the economic impact of usury ceilings. Lack of uniformity of limits and coverage means that some forms of credit are constrained by ceilings while others are not. Under these circumstances, lenders will want to shift their portfolios out of loan categories which are subject to binding ceilings. Lenders may look for alternative opportunities within a state--as appears to have happened, for example, in Minnesota with the shift from conventional to FHA/VA mortgage financing which was exempt from the usury ceiling. However, lenders may also look for opportunities out-of-state. State-imposed usury laws establish interest rate ceilings on credit extended to borrowers within a particular state. But, since credit markets are not confined to state boundaries, lenders have incentives to allocate loans across state lines to borrowers in states which offer the least constraining usury laws. Thus, interstate differences in limits and coverage will distort the geographic distribution of credit and alter the allocation of funds to credit-sensitive economic activities.

Many of the studies cited previously support the notion that a diversity of state usury ceilings affects the geographic distribution of credit. Studies which examined the effect of usury ceilings on credit availability by comparing states with different usury ceilings show both that credit availability is reduced at times when interest rate ceilings are binding and that the reduction occurs in states where the ceilings are binding.

A study by the staff of the New York State Banking Department [10] also indicates how credit flows away from states with binding usury ceilings. The study found that during the period 1966 to 1974, when mortgage market rates were almost continuously above New York's usury ceiling, the proportion of mortgage loans on out-of-state properties rose from 6.5 percent to over 18 percent among savings and loans, and from 18 to 20 percent among banks. Furthermore, over 48 percent of the mortgages held by mutual savings banks were on out-of-state properties which were not covered by the New York usury law. This situation prompted one observer to conclude that New York's mutual savings banks had effectively redlined the entire state because of its restrictive usury ceiling.[19]

In the long run, state differentials in usury ceilings may even affect the location decisions of suppliers of credit and of credit-sensitive economic activities. For example, in marked contrast to other states, there are no consumer finance companies located in Arkansas, which has a comprehensive 10-percent usury ceiling. And that state has a much larger number of pawn brokers than Illinois, Wisconsin, or Louisiana. In addition, a survey of merchants in the adjacent cities of Texarkana, Texas and Texarkana, Arkansas [1] revealed that the Texas side of the border had a much larger number of automobile, furniture, and appliance dealers than the Arkansas side. Furthermore, 84 percent of the merchants interviewed indicated that Arkansas' usury ceiling was an important factor in their preferring a location on the Texas side of the border.

Recent decisions involving the credit card operations of several major commercial banks further illustrate the locational incentives of differences in state usury regulations.[20] In mid-1981 Citibank of New York began moving its nationwide credit card operations to South Dakota. This move was undertaken, in part, because of the there-to-fore failure of the New York legislature to raise its restrictive usury ceiling and because of the absence of a limit on consumer loan rates in South Dakota. When the move is complete Citibank is expected to employ about 2,000 people at its Sioux Falls, South Dakota facility.[21] In the fall of 1981 First National Bank of Maryland and Philadelphia National Bank announced decisions to establish facilities in Delaware to handle consumer lending operations. These decisions likewise were attributed to restrictive usury ceilings in the home states and to the recent removal of limits in Delaware.[22] Finally, a November 1981 announcement by First National Bank of Chicago of its intention to acquire the credit card portfolio of New York's Bankers Trust was also influenced by state usury ceilings. As a result of the September 1981 elimination of consumer loan rate ceilings in Illinois, First Chicago can move processing of the new credit card accounts to its Elgin, Illinois office without their being subject to interest rate limits.[23]

The Macroeconomic Impacts of Usury Ceilings

When usury ceilings affect a state's attractiveness as a site for doing business and for making loans, they may also affect activity in the credit-sensitive sectors of the state's economy. For example, when lenders are less willing to extend mortgage credit in a particular state, the entire home-building industry in the state will suffer. Ostas and Robins, in studies cited earlier, found that binding usury ceilings reduce the number of housing starts or housing permits issued, presumably because they reduce mortgage availability. The New York State Banking Department found that the number of building permits for one-family houses issued in New York during the late 1960s and early 1970s lagged increasingly further behind the numbers issued in 14 states with less restrictive regulation of mortgage lending rates. The study concluded that New York's restrictive usury ceiling was a contributing factor in the depressed condition of the housing market in the state.

Similarly, restrictive usury laws on automobile loans and other forms of consumer credit could affect the level of consumer purchases and retail trade. Some evidence comes from the survey of merchants in Texarkana, Arkansas, and Texarkana, Texas [1]. This survey revealed that, on average, approximately 38 percent of credit sales among merchants on the Texas side of the border were to customers from Arkansas. The study's authors attributed this substantial amount of out-of-state shopping to the comprehensive 10-percent usury ceiling in Arkansas, and they concluded that it "represents a loss of business and jobs by Arkansas-based retailers and tax revenues to state and local governments."

To the extent that a state's economy depends on credit-financed purchases, state employment, income, and expenditures may all be affected by usury ceilings which restrict credit. As the effects of reduced credit availability work themselves through the various sectors, a binding usury ceiling is likely to have a general, depressing effect on the entire state economy. A study by Richard Gustely and Harry L. Johnson, described by Harold Nathan [14], used an econometric model of Tennessee to examine the impact of that state's comprehensive 10-percent usury ceiling. The authors reportedly found that Tennessee's economy grew faster than the national economy except at the times when market interest rates exceeded the state usury ceiling. They also estimated that between 1974 and 1976 the state lost an average of $150 million per year in output, 7,000 per year in employment, and $80 million per year in retail sales due to the usury regulation. Thus, rather than stimulating a state's economy by keeping interest rates down and encouraging investment, binding usury ceilings may dampen the economy by driving investment and expenditures to states which offer less restrictive usury ceilings and thus more attractive earning or consuming opportunities.

V. Usury Ceilings and Competition

As the foregoing discussion has shown, usury ceilings have many more consequences than simply holding a lid on interest rates. The additional consequences may even be sufficiently adverse to outweigh the benefit to borrowers of below-market interest rates. However, evaluation of usury laws is not complete without also considering the consequences of not having usury ceilings.

A commonly heard argument is that without usury laws, borrowers would be forced to pay exorbitant interest rates, or at least rates that were unreasonable in relation to the cost of supplying credit. The basis for this claim seems to be a general feeling that lenders have excessive market power and thus in the absence of regulation they would be able to charge virtually whatever price they desire.[24] According to economic theory, it is competition which ensures that lenders are not able to exercise such power over pricing and to earn more than a normal return. The price of a good established under competitive market conditions will reflect suppliers' costs of providing the given amount of the good. To be sure, removing a usury ceiling which had been binding will result in higher interest rates. However, if credit markets are competitive, then the market rate of interest will be consistent with lenders' cost of providing credit. It is when competition is absent that consumers are apt to face unreasonable interest rates. Thus, the consequences of not having usury ceilings depend importantly on the competitive status of credit markets.

There are several reasons to suppose that U.S. credit markets are fairly competitive. A wide variety of types of institutions make up the supply side of the credit market. Banks, finance companies, credit unions, thrift institutions, and retailers all provide credit to the public, and frequently these institutions offer credit in closely substitutable forms. For example, personal loans are available through banks, bank credit cards, finance companies, credit unions, and some thrifts. Automobile loans are offered by dealers, many thrifts, banks, credit unions, and finance companies. Today the consumer credit field is feeling the influx of new types of institutions and new services being offered by traditional financial institutions. Moreover, in many places consumers can choose among several lenders of any particular institutional type.

However, competition in credit markets may be hampered by the fact that lending institutions have become specialized according to the types of credit they offer and/or the types of borrowers they serve. In the area of personal consumer credit, for example, banks and other depository institutions primarily offer cash credit to lower risk borrowers while finance companies specialize in servicing higher risk customers.

Thus, the question of whether credit markets are sufficiently competitive to protect consumers from unreasonable interest charges is one which must be answered empirically. Unfortunately, this is difficult to do. Evidence on the extent of competition is scanty, confusing, and does not provide a definitive answer to the question.[25]

One way in which to examine competitive pressures is to study how interest rates vary among states with different usury ceilings. If market rates are predominantly national, then actual interest rates consistently at the maximum permitted by state usury law, regardless of how high or low each ceiling is, may indicate that lenders set prices without competitive pressure from the market. However, observed rates below ceilings in some high-ceiling states could indicate that lenders are subject to price competition.[26] Two studies have reported on comparisons of observed rates on various types of loans and the corresponding state rate ceilings.[27]

Paul Smith [22] studied a sample of 497 commercial banks from 27 states with different banking structures. As part of his analysis Smith grouped banks by whether they were located in states with high, moderate, or low usury ceilings. He then compared average bank interest rates across these three groups of states. What he found was that even in low ceiling states not all banks charged rates at the ceiling; some charged below the legal limit (and some even charged above the ceiling). Furthermore, in the group of high-ceiling states, average rates on secured loans and on all but the smallest unsecured loans were equal to or below the rates in states with moderate rate ceilings. Even for small unsecured loans (less than $300), the average rate charged in high-ceiling states was only .15 percent above the rate in the moderate ceiling states. These results are consistent with a notion that price competition is practiced in the bank personal loan market.

The Report of the National Commission on Consumer Finance [15] also compared observed interest rates and state rate ceilings. The Commission conducted a 50-state survey in the second quarter of 1971 concerning three types of consumer lending--$3,000 new car loans by commercial banks, $1,000 unsecured loans by banks, and personal installment loans by finance companies. For bank auto loans, the average observed rates of charge in the 50 states clustered around 10 percent; state rate ceilings, on the other hand, ranged from 8 percent to as high as 24.85 percent. Even in the six states which had no usury ceilings, average observed auto loan rates were still in the same general range--9.2 percent to 10.7 percent. For unsecured bank loans, the Commission found average observed rates to be higher than the secured auto loans, as might be expected from their greater risk. Rates on these loans also showed more interstate variation, ranging between 12 percent and 16 percent. In no state, however, was the average observed rate above 16 percent, although 6 states had no legal ceiling and the limits were as high as 28 percent among states with ceilings. States with limits below 12 percent tended to have actual average rates very close to the legal limits, suggesting that these ceilings were effectively impinging on the market rate. (Interestingly, five states had average rates on unsecured loans which were above the legal limit, and the limits in these states were all about 12 percent or less.) Thus, in both the auto loan market and the personal loan market at banks, there appears to be some pressure holding interest charges below a certain limit regardless of the usury ceiling.

The Commission's findings on finance company loans contrasted with its findings on bank loan rates. In the finance company loan market, the Commission noted a much closer correspondence between observed rates and the state usury ceilings, however high or low the ceilings were. The Commission reported that in 42 states at least 80 percent of the cash loans made by consumer finance companies fell within 10 percent or less of the state usury ceiling. The Report emphasized that even here not all loans were made at the maximum allowable rates. Nevertheless, finance companies appear more ready than banks to charge the highest rate allowed.

Another way to gauge competitive pressures is to examine the influence that different types of lending institutions have on each other's behavior. Smith [22] looked at the effect which the presence of finance companies has on commercial bank lending. He reported that the number of finance companies located within 100 square miles of a commercial bank had a negative effect on the bank's average interest charge. Also, he found that banks had larger average loan sizes, fewer loans, and a smaller percentage of unsecured loans the greater the number of finance companies. Smith concluded that all of these relationships point to "considerable interaction between finance companies and banks despite the difference in the markets they serve" (p. 524). This conclusion must be looked at with some circumspection, however, because of discrepancies between Smith's text and his accompanying Table 3 and because of obvious printing errors in the table. Further clouding the issue of the extent of interinstitutional competition is a technical study for the National Commission on Consumer Finance by Douglas Greer [5]. Greer analyzed correlations between finance company rates and rates charged by banks and also ran regressions to explain loan rates and credit supplies in each segment of the market. According to Greer, his data do not support a firm conclusion of vigorous competition between finance companies and commercial banks.

It is impossible from the evidence cited here to draw an overall, definitive conclusion about the extent of competition in credit markets. The studies described here suggest that competitive behavior may vary considerably among different segments of the credit market. Rates on finance company personal loans, for example, appear to be set less competitively than rates on auto loans or personal loans extended by banks. Moreover, it is unclear how much competitive pressure lenders in one institutional segment of the market exert on lenders of other institutional types. Another factor which makes an overall assessment of competition difficult stems from the great differences in local market conditions. Lending institutions located in urban areas may face much greater competitive pressures than lenders in smaller cities or towns.

What can be stated definitively, however, is that from the point of view of protecting borrowers from unreasonable interest charges, competition is desirable, and the more the better. To the extent that competitive pressures arise from the presence and ready entry of many firms into the market, consumers are best served by policies which foster these conditions in credit markets.[28]

There is some evidence that usury ceilings, rather than fostering these conditions, tend to restrict competition in some parts of the credit market. The National Commission on Consumer Credit (NCCF) found, for example, a strong inverse relationship between finance company concentration ratios in the personal loan market and the average level of legal rate ceilings on personal loans. (Higher concentration ratios are usually associated with lower levels of competition.) The relationship was even stronger among only low-ceiling states. This finding that lending firms tend to be more highly concentrated the lower are state rate ceilings can be attributed to several factors. First, low usury ceilings drive inefficient firms out of the market, thereby increasing concentration, [6, p. 1377]. In addition, low usury ceilings create barriers to entry making it difficult for new firms to compete during the start-up phase [15, p. 137].

Rate ceilings have been implicated for restricting competition in various other ways. The NCCF argued that different rate ceilings for different lenders tend to artificially segment the market and restrict competition among different types of consumer lenders [15, p. 147]. Indeed, ceilings are often set at different levels for certain institutions, encouraging them to specialize in servicing borrowers of certain risk categories and effectively segmenting the market [5, p. 60]. Another difficulty with usury ceilings, according to Shay, is that they may provide an incentive for tacit collusion among some lenders. Rate ceilings may offer convenient focal points for setting rates higher than they might otherwise be set [21, p. 407]. (In short, the rate ceiling could become a floor.) Finally, the Treasury Department's Interagency Task Force on Thrift Institutions [23] recently argued that very low usury ceilings discourage thrift institutions from acquiring consumer loans in their portfolios and from actively competing with finance companies by offering consumer loans.

If these arguments are true, then credit markets may actually become more competitive with the removal or easing of usury ceilings. Lenders may face more interinstitutional competition and consumer lending may be seen as a more feasible and attractive line of business, enhancing the number of firms in the market.

Competitive pressures are also fostered by the existence of a group of knowledgeable borrowers. When consumers are not aware of the market, when they do not know or cannot compare rates being offered by various lenders, each lender has more scope to charge whatever rate he chooses. Thus, the extent to which the market places natural constraints on interest rates (in lieu of the external constraints of usury ceilings) depends, in part, on the level of borrowers' awareness. A 1969 survey of consumer credit awareness sponsored by the Federal Reserve Board found borrowers were relatively poorly informed about annual percentage rates. Only 15 percent of the credit users in that survey were classified as aware of the annual percentage rates on closed-end credit. Awareness levels were higher on retail revolving credit (35 percent) and bank credit cards (27 percent). How do these results relate to the price competitiveness of credit markets? As the National Commission on Consumer Finance pointed out "Not all consumers need be aware of the APR [annual percentage rate] or shop for credit to bring about effective price competition. A significant marginal group of consumers who are aware and do shop is sufficient to 'police' the market" [15, p. 175]. It is difficult to say exactly what the size of that group needs to be, but the Commission suggested that one third to one half of the borrowers is certainly sufficient. By this criterion, consumers did not exert very effective pressure on lenders in 1969.[28]

However, the 1969 survey was conducted before passage of federal consumer protection legislation in the 1970s and before the Truth-in-Lending Act (Title 1 of the 1968 Consumer Credit Protection Act) could have had any impact. Two more surveys using the same criteria to classify consumers by awareness levels were undertaken during the 1970s--one in 1970, 15 months after passage of the Truth-in-Lending Act, and another in 1977. A Federal Reserve Board comparison [4] of the results of these later surveys with the earlier 1969 survey shows a steady increase in consumer awareness. Awareness levels on closed-end credit climbed to 38 percent in 1970 and to 55 percent in 1977. By 1977 consumer awareness of annual percentage rates on retail revolving credit and bank credit cards stood at 65 percent and 71 percent respectively. Data from these three surveys do not permit rigorous analysis of the reasons for the substantial increase in borrowers' knowledge of the market. Nevertheless it seems reasonable to attribute at least some of the improvement to the consumer protection legislation enacted in the past decade. The suggested impact of such legislation on improving the environment for price competition in the credit market, in turn, indicates that there exist effective alternatives to usury ceilings to ensure consumers of reasonable interest charges. Legislation, such as Truth-in-Lending and state disclosure laws, which does not interfere directly with individual market decisions can still provide protection to consumers from anticompetitive credit pricing practices.

V. Policy Options

The weight of the economic evidence on usury ceilings generally supports the current legislative trend toward relaxation or elimination of interest rate controls. Usury ceilings create a variety of allocative and distributive problems which adversely affect borrowers as well as lenders. Furthermore, it is not even clear that ceilings effectively constrain the price of credit, if one considers the total overall cost of borrowing and not just the explicit interest or finance charge.

There are several ways to design policies to deregulate interest rates in order to ease the adverse economic impacts of usury ceilings. One is to raise, but not eliminate ceilings, when they begin to have restrictive effects on credit availability and economic activity. This approach preserves statutory interest rate limits and whatever protection they do afford consumers from outrageously high interest charges. But its effectiveness depends on the ability of state legislatures to act with appropriate deliberation and timeliness to raise usury limits in response to increases in market rates.

A second approach, floating ceilings, avoids this problem and preserves the protection afforded by statutory limits. Under this approach, usury ceiling limits automatically adjust at frequent intervals to changes in other interest rates. Such floating ceilings are usually set at a stipulated number of percentage points above other specified market interest rates--such as Treasury bill yields or the Federal Reserve discount rate--over which neither borrowers nor lenders have control. The difficulty with floating ceilings is the choice of an appropriate tie-in formula which will keep the ceiling from impinging on the market rate for a particular type of credit. In a 1979 study of floating ceilings in the mortgage market, the Federal Reserve Bank of St. Louis [11] concluded that ceiling rates set 2.5 percentage points above yields on ten-year U.S. Treasury bonds or 5 percentage points above the discount rate were high enough not to distort the flow of credit to housing. Other floating rate schemes, however, continued to bind mortgage rates and impede housing activity.

Finally, usury ceilings could be eliminated. Illinois, New York, and many other states have recently lifted their ceilings on most or all forms of consumer and commercial credit. In addition, the 1980 Monetary Control Act temporarily preempted state limits on mortgage loans and on large business and agricultural loans. The same act also overrode state interest ceilings on loans by national and state banks, S&Ls, and credit unions when the state ceiling is below the local Federal Reserve discount rate plus 1 percent. Proposals to extend federal preemption to include consumer credit were considered during the 1981 Congressional session. (A Senate version was introduced by Senator Lugar and incorporated in S. 1720 by Senator Garn; House versions were sponsored by Representatives John La Falce and Bill Alexander.) It is expected that some action will be taken on similar proposals during the upcoming session as part of legislation to restructure the entire financial regulatory system.

The move by the federal government to deregulate state usury ceilings raises an important and difficult issue. From an economic point of view there is a clear benefit to be gained from such federal action. It would impose uniformity on credit markets, eliminating legislatively created differentials in interest rates which artificially distort credit flows among states. The same benefits of uniform treatment could be achieved, of course, whether the federal government overrode state ceilings by specifying its own fixed or floating interest rate limits or by eliminating ceilings altogether. However, this benefit needs to be weighed against the political implications of the federal government stepping into an area which has traditionally been under the jurisdiction of the states. Economic analysis alone does not permit one to say whether deregulation of usury ceilings should be left to individual states or whether it is best accomplished by federal preemption.

Footnotes

[1] For a simple theoretical treatment of usury ceilings see Chapter 9 in James Van Horne Financial Market Rates and Flows. For a more advanced discussion see Rudolph C. Blitz and Millard F. Long "The Economics of Usury Regulation." Journal of Political Economy, December 1965.

[2] We use the term usury laws generally to include comprehensive usury laws as well as any other statutes which establish maximum interest rates or finance charges on specific credit transactions.

[3] What has happened in many states over the last decade is that for various economic reasons market interest rates have risen above what were initially nonbinding statutory ceilings. While the ceilings always existed, only recently have they begun to impinge on the market.

[4] A binding ceiling would not lead to reductions in credit supply if the supply curve were perfectly inelastic. That is, if supply were completely insensitive to price (interest rates), then imposition of a ceiling would lower the interest rates charged consumers without reducing the quantity of credit lenders made available. (See Van Horne, [24] p. 220). It is quite unrealistic, however, to suppose that credit supply does not respond at all to variations in interest rates.

[5] Among the independent variables included in these regressions were bank reserves and the rate on federal funds. Bank reserves were added to control for the fact that loan growth would be expected to fall during periods of high interest rates if banks are losing deposits. The federal funds rate was intended to control for the fact that higher interest rates present banks with higher costs of purchased funds or with greater returns to nonloan assets. For both reasons, loan volume would be expected to fall as market interest rates rose.

[6] The exceptions were loans to nondurable and durable manufacturing, and loans to service industries. Keleher speculates that these loans were not adversely affected by the ceiling because of previous commitments, strong customer relationships, and nonprice rationing.

[7] Furthermore, it indicates that the ceiling did not succeed in protecting all borrowers from mortgage financing rates above 8 percent, since the interest rate on FHA-insured loans ranged between 8.5 and 10.5 percent during this period.

[8] Ostas estimated the maximum impact for a one percentage point spread to be 19 percent. Other studies utilized an alternative, observable interest rate (such as the secondary market yield on FHA mortgages) to measure the spread between ceilings and market rates; Ostas developed an estimate of the equilibrium market mortgage rate

from a model of the opportunity costs of mortgage lenders in cities with unconstrained rates and used this to measure the spread.

[9] Despite finding this impact on the number of loans extended, however, McNulty did not find that Georgia's ceiling had a significant impact on housing construction. McNulty believed this was because Georgia's ceiling was only moderately, and briefly, restrictive during the period under study.

[10] If the average size of each loan were to rise while the number of loans falls, the usury ceiling might not affect the total dollar volume of loans extended.

[11] Peterson distinguished cash credit from non-cash or point-of-sale credit. The former is in the form of direct loans while the latter is credit obtained from dealers at the point-of-sale or on credit cards.

[12] This situation is similar to that found in the Federal Reserve study of the mortgage market in Minnesota. In both cases the binding usury ceiling altered the mix of loans in favor of those on which lenders could better protect their revenues.

[13] Increasing minimum loan sizes also increases the rate of return. By extending credit on fewer but larger transactions, lenders reduce their administrative costs per dollar of credit extended. This is because costs generally do not increase proportionately with increases in the amount of individual loans.

[14] Many states also regulate these fees and charges in addition to regulating interest rates and finance charges.

[15] Phaup and Hinton also found a much larger impact of usury ceilings on new mortgage lending than Ostas, Robins, or McNulty. They found a one percentage point increase in the market-ceiling spread was associated with a 31 to 38 percent decline in new mortgages. They attributed the difference in magnitude to the severity of New York's ceiling as well as to differences in the data and model.

[16] These special statutes originated in the 1910s and 1920s because legal commercial lenders could not afford to make the more costly consumer loans at rates under the contract rate ceiling (which still in many states is in the 8 to 10 percent range). Much of the consumer demand for credit in the late 19th and early 20th centuries went to illegal loan sharks. To remedy this situation, states authorized the organization of consumer credit organizations under special higher ceilings above the usury limits but below loan shark rates. See Mors [13] pp. 9-22.

[17] Sales or retail credit, in particular, has been treated differently from other types of credit. According to the courts, credit sales are not to be regarded as the extension of a loan and therefore they are not subject to general usury ceilings. Under

the time-price doctrine, as it came to be called, the courts recognized retail credit as the sale of goods under different conditions than cash sales. Since the conditions of sale were different, retailers could charge a different price for cash and credit customers. This price differential was the time-price. It was not the same as interest charged for the advance of money. This legal interpretation led states to adopt separate legislation regulating the finance charges imposed by retail creditors. See Mors [13] p. 20.

[18] A 1981 listing by the Financial Institutions Bureau of the Michigan State Department of Commerce contains 25 different loan categories subject to interest rate ceilings imposed by state law. The current effective maximum rates ranged from 5 percent on personal loans by individuals for nonbusiness purposes to 36 percent on loans by pawnbrokers. A 1980 survey of Iowa usury laws summarized that state's current interest rate ceilings under 9 categories with maximum permitted rates ranging from 5 percent (the legal rate) to 36 percent (the maximum rate on the first $500 of loan by a chattel loan licensee).

[19] Harold C. Nathan "Economic Analysis of Usury Laws." Journal of Bank Research 10 (Winter 1980) p. 206.

[20] The ability of banks to take advantage of interstate differences in ceilings on credit card lending derives from a 1978 Supreme Court ruling. In Marquette National Bank vs First of Omaha Service Corporation, the court determined that national banks may charge out-of-state credit customers the rate permitted by the law of the bank's home state. See Federal Reserve Bulletin, February 1981, p. 181 fn. The same option does not apply to department stores, gasoline companies, or other issuers of retail or sellers' credit cards.

[21] Wall Street Journal, 12/15/81.

[22] American Banker, 9/30/81 and 10/30/81.

[23] Wall Street Journal, 12/5/81.

[24] Contemporary attitudes toward lenders may be a remnant of earlier times when the taking of interest (usury) was entirely proscribed. Charging interest was not generally permitted until the 16th century, and it was not until the late 19th century or early 20th century that it became socially acceptable for individuals to purchase consumption goods on credit.

[25] Actually, economic models of competitive and imperfectly competitive markets lead to some very specific conclusions about how loan pricing and supply should vary with usury ceilings under different market structure. Tests of hypotheses about competitiveness thus include examining variations in both interest rates charged and credit availability.

We have already seen that loan availability should decline with binding usury ceilings in a competitive credit market. In an imperfectly competitive market on the other hand, how a usury ceiling affects credit supply depends on just where the ceiling lies. Over some range of interest rates, lowering the ceiling may actually result in *increasing* the amount of credit supplied. As the rate ceiling is lowered still further, however, eventually it will impinge on lenders' costs and will finally result in a smaller supply of credit than in the absence of any interest rate limit. See National Commission Consumer Finance Report [15], Chapter 16.

The notion that a price ceiling may actually increase supply in an imperfectly competitive market is sometimes used to justify the use of price regulation to control lenders' monopoly power. Of course, the effectiveness of usury ceilings for this purpose depends crucially on choosing the appropriate legal interest rate limit. Furthermore, this policy does nothing to affect the source of the market power.

[26] Such a situation could also indicate, however, that all the usury ceilings were above the optimal price for an imperfect competitor. See Greer [7], p. 79.

[27] In addition, an investigation by the Federal Reserve Bank of St. Louis revealed that mortgage rates in the Chicago, Minneapolis, and Pittsburgh SMSAs did not rise to state ceilings when these usury limits were allowed to float. See Lovati and Gilbert [11].

[28] The literature on the structure of banking markets has established that there is a highly significant, although quantitatively small, effect of firm entry and concentration on competitive pricing behavior. See Stephen Rhodes, "Structure-Performance Studies in Banking: A Summary and Evaluation, *Staff Economic Studies 92*, Board of Governors of the Federal Reserve System, 1977; Harvey Rosenblum, "A Cost-Benefit Analysis of the Bank Holding Company Act of 1956," *Proceedings of a Conference on Bank Structure and Competition*, Federal Reserve Bank of Chicago, 1978; and George Bentson, "The Optimal Banking Structure: Theory and Evidence," *Journal of Bank Research*, 3 (Winter 1973).

[29] In analyzing the results of the 1970 survey referred to below, the Commission found sufficient awareness levels existed in the 'general market'--the market comprised mainly of higher income, more highly educated, white, homeowning borrowers who live in nonpoverty areas and use mostly cash credit. The high-risk market on the other hand had disturbingly high levels of unawareness.

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GENERAL MOTORS ACCEPTANCE CORPORATION
GENERAL MOTORS BUILDING
DETROIT, MICHIGAN 48202

ROBERT F. MURPHY
PRESIDENT

April 8, 1983

The Honorable E. J. Garn
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Garn:

General Motors Acceptance Corporation (GMAC) wishes to take this opportunity to express its support for S. 730, the Credit Deregulation and Availability Act of 1983, which would remove all remaining rate ceilings on business, agricultural and consumer credit.

GMAC is a wholly-owned sales finance subsidiary of General Motors Corporation whose principal business is to finance the inventory of new products held by General Motors dealers and to acquire from such dealers instalment obligations covering retail sales and leases of new and used products. During 1982, GMAC financed 3.4 million vehicles amounting to $35.6 billion at wholesale for General Motors dealers in the United States, and acquired from such dealers instalment contracts covering retail sales of over 2.3 million new and used vehicles totaling over $23 billion.

GMAC supports the concept that interest rates should be determined by competition in a free marketplace without restrictive ceilings, which actually are artificial price controls on the cost of credit.

Financial organizations such as GMAC, which must raise their operating funds in today's competitive and unregulated money market, must be able to receive a reasonable return on these funds to insure the consistent availability of credit.

The most significant impediment to receiving a reasonable return, especially during periods of high money costs, has been restrictive rate ceilings. GMAC shares the hope of all our citizens that we will never again see money costs as high as those experienced in recent years. We believe it is essential, however, that the marketplace be in a position to accommodate all possibilities, and we agree with your comments that the only way this can be accomplished effectively is to allow the marketplace to be the arbiter of interest rates.

A number of states have taken action to either raise their ceilings to more realistic levels or in some cases remove them altogether. It should be recognized that in those states competition has served to keep market rates at comparatively low levels.

We firmly believe that the remaining disparity among state rate ceilings, the failure of some states to act promptly on the need for change, and ceilings tied to artificial or unrealistic indicators, all demonstrate the need for Federal preemption.

GMAC is pleased that S. 730 would also eliminate the concept of a Federal ceiling pegged to the Federal Reserve discount rate. As a tool of monetary policy, we agree that the discount rate is an inappropriate indicator of money costs.

The efforts of this committee toward enactment of a Federal preemption of business, agricultural and consumer credit rate ceilings are indeed appreciated and wholeheartedly supported by GMAC. We respectfully request that this letter be made a part of the hearing record.

Yours very truly,

Murphy

Robert F. Murphy
President

bjs

President
JAMES D. HERRINGTON, Board Chairman
Coldwater National Bank
Coldwater, Kansas 67029

First Vice President
PAUL H. BRINGGOLD, President
First National Bank
Cannon Falls, Minnesota 55009

Second Vice President
A.J. (JACK) KING, President
Valley Bank of Kalispell
Kalispell, Montana 59901

Treasurer
JAMES R. TAYLOR, President/CEO
McKeesport National Bank
McKeesport, Pennsylvania 15132

Independent
BANKERS ASSOCIATION OF AMERICA
WASHINGTON OFFICE
1625 MASSACHUSETTS AVENUE N.W. · SUITE 202, WASHINGTON, D.C. 20036 202/332-8980

April 6, 1983

The Honorable Jake Garn
Chairman
Senate Committee on Banking, Housing
  and Urban Affairs
5300 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Mr. Chairman:

The Independent Bankers Association of America is the national trade association of community banks representing approximately 7100 state and nationally chartered, small and medium-size banks in 48 states and the District of Columbia. Most IBAA members serve rural and suburban markets and supply most of the credit needs of households, farmers and small business in their respective communities. IBAA commends you on the introduction of S. 730, the Credit Deregulation and Availability Act of 1983 and submits the following comments in support of elimination of interest rate ceilings applicable to business, agricultural and consumer credit.

As you are aware, Mr. Chairman, the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221) initiated the deregulation of interest rate ceilings on credit by preempting state ceilings on mortgages and establishing an alternative, temporary federal ceiling (5% above the Federal Reserve discount rule) for business and agricultural credit for loans of more than $25,000. This three-year preemption which expired on April 1 of this year helped insure the availability of credit to the business and agricultural sectors of the economy.

The same legislation that included the usury preemption also provided for the phase-out of interest rate ceilings on deposit accounts no later than April 1, 1986. Rapid and unprecedented changes in the marketplace have caused Congress to accelerate this deregulation schedule. The Conference Committee Report on the 1980 Deregulation Act clarified that the phase-out of interest controls "must be accomplished in a way that ensures equity for depositors... and ensures competitive equity among depository institutions, and between depository institutions and non-depository institutions that compete for the savings dollar." Almost two years after the enactment of the 1980 Act and after four years of the unbridled growth of money market funds which siphoned off billions of deposit dollars once available to meet the credit needs of small business, farmers and consumers, the Garn-St Germain Depository Institutions Act of 1982 virtually eliminated the remaining rate ceilings on bank deposits. Clearly, financial institutions cannot continue to pay market rates on deposits without matching authority to charge market rates for credit.

IBAA supports the enactment of S. 703, the Credit Deregulation and Availability Act, as a means of deregulating the asset side of our banks' balance sheets. In addition to abolishing rate ceilings that apply to consumer credit transactions, S. 703 eliminates the rate ceilings on business and agricultural loans, insuring flexibility for interest rates rather than imposing an alternate Federal ceiling indexed to the discount rate.

The IBAA has traditionally advocated the right of the individual states to determine state banking structure. The three year period for state override of the preemption in S. 703 plus the retention of state consumer protection laws recognize the individual authority of each state to ultimately determine interest rate structure. Generally, a states' rights banking policy acts to assure that logical credit needs are met. However, state-imposed usury limits, while purporting to reduce credit costs to local businesses, actually often result in a lack of available credit during times of high interest rates. Local bankers must often, reluctantly, divert funds to uses outside their state or business area when usury limits prevent a positive real rate of return on local credit extensions.

Although the rate of inflation has recently subsided, a continued inflationary expectation due to future Treasury borrowing to finance a federal deficit of over $200 billion plus the unpredictable nature of the nation's economy demand a flexibility in interest rates to guarantee credit availability.

The average IBAA member is acutely aware of the impact of interest levels on farmers and small businessmen. Usury ceilings in no way help to protect small business in difficult times. If anything, interest rate ceilings hasten their demise by making it more difficult to work out credit packages which promote survival. Approximately 40% of the assets of all IBAA members are in agricultural loans compared to an industry average of 3%. Usury ceilings do not enhance the survival of U.S. agricultural producers--their current problems are due to a three year decline in commodity prices from a net level of $26.7 billion in 1979 to $19.6 billion in 1982. No interest rate, no matter how low, can be of assistance to a farmer whose cost of production consistently exceeds his return on sales.

From agriculture's perspective, another very helpful step would be the withdrawal of the bank regulators' proposed new requirement which would go into effect June 30 making banks' past due loan information publicly available. Giving publicity to delinquent loans is certain to tighten the lending practices of banks to avoid the appearance of having too many "bad" loans, and would hamper workout procedures and discourage forebearance on past due loans. This proposal would especially affect agricultural banks and borrowers adversely because of the extended debt position of many farmers at the present time.

Recognizing that artificial government-mandated rate ceilings will not promote an uninterrupted flow of loanable funds to our banking customers, the IBAA supports a uniform preemption of interest rate ceilings and adherence to sound monetary and fiscal policy.

Thank you for the opportunity to comment on the views of the Independent Bankers Association regarding this issue.

Sincerely,

James D. Herrington

James D. Herrington
President

JDH/sld

National Association of Federal Credit Unions
P.O. Box 3769
Washington, DC 20007
703/522-4770

April 8, 1983

The Honorable Jake Garn
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

On behalf of the National Association of Federal Credit Unions (NAFCU), I would like to commend you and your colleagues Senator Proxmire and Senator Lugar for introducing S. 730, "The Credit Deregulation and Availability Act of 1983." NAFCU, as the only national trade association exclusively representing the interests of federally chartered credit unions, is vitally interested in this legislation. Therefore, we are pleased to comply with the Committee's request to submit this letter for the hearing record. I shall restrict my comments to Section 4 of the bill which deals with Federal credit unions and, thus, directly affects our membership.

This association has traditionally opposed all ceilings and floors set on the cost of funds. We feel our position on usury ceilings has been made clear on several occasions in testimony before this Committee. NAFCU members have consistently reaffirmed our long standing position that the marketplace, unhampered by government regulation, should establish the rate charged on loans, as well as dividends paid to savers.

Thanks to the hard work of you and your colleagues in the Senate and the House, the Garn-St Germain bill was enacted into law last year. This bill was a major step toward allowing the board of directors of a Federal credit union to set policies governing their individual institutions. It is our belief that the boards of directors have used this new authority in a prudent and sensible manner. In keeping with the theme of deregulation set forth by the Garn-St Germain Act, NAFCU believes that Federal credit unions should be permitted to determine what loan rates they should charge their members, without the imposition of an artificial ceiling.

Mr. Chairman, as you mentioned in your floor statement when introducing S. 730, Federal credit unions are the only class of financial institutions governed by a federal consumer usury ceiling. We strongly support Section 4 of S. 730 which would abolish this ceiling and, therefore, permit the boards of directors of Federal credit unions to be responsible and accountable for setting their own loan rates. While the National Credit Union Administration currently has the authority to adjust the ceiling to reflect the needs of credit unions and their members, this system is burdensome and inefficient for all concerned.

NAFCU believes that usury ceilings have traditionally had an adverse effect on both lenders and borrowers. When market interest rates rise above the ceiling, the supply of credit diminishes and low-income, high risk borrowers are treated unfairly as the ceiling impedes the payment of fair rates on deposits. The only way to pay market rates on funds is to charge market rates on loans. Restrictive usury ceilings prevent this from happening. These laws were originally designed to protect consumers; they now serve to hinder both borrowers and lenders.

From a managerial standpoint, usury ceilings can cause many planning and administrative headaches. Credit unions and other lenders are many times thrust into a world of economic uncertainty due to the unpredictable fluctuation of market rates.

In conclusion, Mr. Chairman, I would like to reiterate NAFCU's full support of Section 4 of S. 730 dealing specifically with Federal credit unions. We believe this is the next logical step of the long march begun by the Garn-St Germain Act towards the total deregulation of financial institutions.

I would also ask that this letter be made part of the official hearing record on S. 730. We appreciate the opportunity to present our views, and if you need further information regarding the effect of S. 730 on Federal credit unions, please do not hesitate to contact our executive vice president, Mal Nestlerode, or our director of government affairs, Bill Donovan, at 522-4770.

Sincerely,

John J. Hutchinson
President

JJH/yk

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

NEW YORK, N.Y. 10166

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LOUIS H. NEVINS
Senior Vice President and Director
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WASHINGTON, D.C. 20006
TEL. 202: 783-8144

April 11, 1983

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

On behalf of its member institutions, the National Association of Mutual Savings Banks is pleased to endorse S. 730, legislation to preempt state usury ceilings on agricultural, business and consumer loans. Such a step would represent a logical progression in the deregulation of the financial services business.

Federal preemption of state usury ceilings on business and agricultural loans dates back to 1974, and has worked well for the institutions affected as well as business borrowers newly eligible to qualify for credit. Although this legislation has been renewed several times, it lapsed as of April 1, 1983, and should be reenacted on a permanent basis as quickly as possible in order to avoid disruptions in the marketplace. Section 2 of S. 730 would accomplish this, and we support, in particular, the definition of "credit" contained in Subsection 511(b)(4) which would apply in those states such as New York which continue to impose usury limits on business loans made to noncorporate borrowers.

Section 3 of the legislation would, for the first time, preempt state usury ceilings with respect to consumer credit. This action would not merely follow the 1974 precedent for business loans but would also be in keeping with the 1979 federal legislation preempting state usury ceilings on mortgage credit. Inasmuch as mutual savings banks are primarily mortgage lenders, we can well attest to the beneficial impact which federal preemption of state limitations on mortgage interest rates has had on keeping at least some funds flowing into housing finance during the unprecedented thrift industry crisis of the past several years. Again, drawing upon the experience in New York which maintained an extremely low mortgage usury ceiling throughout the 1970's, there have been a number of independent studies, including one by the New York State Banking Department, showing that the effect of this law was to force New York-based institutions to direct a good deal of their mortgage lending to out-of-state locales.

The rationale applicable to business and agricultural loans and to mortgage loans would seem to be equally persuasive in the area of consumer credit. The consumer credit market is already a highly competitive one, but savings banks and other thrift institutions, armed with newly granted or recently expanded consumer lending powers, are poised to become active participants in this market. The reason is that consumer installment loans, whether they be closed-end or open-end, provide an excellent investment vehicle for balancing the predominantly long-term asset structure of a thrift institution.

Lifting usury ceilings on this type of credit will facilitate entry by reducing regulatory compliance and other nonmarket costs of doing business. As was well stated in the Report of the *Interagency Task Force on Thrift Institutions*, prepared by the Treasury and transmitted to the Congress on June 30, 1980, "the existence of usury ceilings frustrates the expansion of thrift institution asset powers." (page 70). Encouraging participation in this market by as many credit grantors as possible can only work to the best interests of credit users.

The documentation with respect to the ill effects of usury ceilings in the consumer credit area is quite pervasive. A number of these studies have already been reviewed in the course of previous congressional hearings on this subject and need not be recited here. However, we would like to quote from one which, at least in our view, is precisely on point. As it appeared in the June, 1982, issue of *Economic Perspectives*, published by the Federal Reserve Bank of Chicago, the study summarized the evidence on usury ceilings as follows:

> "The broad conclusion that emerges from these empirical studies is that usury ceilings create a climate in which lenders are able to pursue practices unfavorable to some or all borrowers. On balance, usury ceilings appear to be a type of regulation whose benefits to borrowers are extremely questionable...borrowers may end up facing higher noninterest credit charges and less favorable terms as a result of usury ceilings. Moreover, attached to the lower-interest benefit of usury ceilings is a direct cost to the borrowing public in the form of a reduced supply of credit."

A final argument in favor of S. 730 is that bank deregulation, which began in earnest in 1980, has now progressed to the point where virtually all time deposits at financial institutions are either unregulated or subject to market-linked indices. Deregulation of liabilities at depository institutions continues apace, with the money market account introduced in December being the best evidence by far that consumers are now demanding a market rate of return on their investments. The recurrent earnings crises incurred by the thrift industry in recent years have been caused by an inability to keep its asset portfolio abreast of changes on the liability side of the balance sheet. Many of these restrictions have, of course, been the result of government-directed investment policies and regulations such as usury ceilings which distort the flow of funds in the marketplace. In order to achieve the proper matching of assets and liabilities, it is essential that the federal government preempt conflicting state usury ceilings just as it has taken the lead in deregulating bank liabilities.

While on the subject of treating assets and liabilities in a consistent manner, there is one aspect of bank regulation which should be addressed concurrently with congressional action on state usury ceilings. We refer specifically to the inability of corporations and certain other business borrowers to establish money market accounts. The DIDC considered this issue at its March meeting, but failed to take any action based in part upon a perception that the Congress felt that deregulation had already proceeded too quickly in the months immediately preceding that meeting.

When the DIDC next meets in June, the markets will surely have had sufficient time to adjust to the new instruments introduced at the end of last year. With the Congress hopefully moving toward lifting restrictions on interest rates which may be charged business entities, it is only appropriate that the limitation on the ability of a corporation to earn interest on its transaction balances be likewise removed. No statutory change is necessary to accomplish this purpose, and thus we respectfully suggest that the committee report accompanying S. 730 include language urging the DIDC to authorize money market accounts for corporate and noncorporate businesses.

We appreciate the opportunity to express these views, and request that this letter be included in the official hearing record.

Sincerely yours,

Louis H. Nevins
Senior Vice President and Director

National Automobile Dealers Association
8400 WESTPARK DRIVE • MCLEAN, VIRGINIA 22102

April 11, 1983

The Honorable Jake Garn
Chairman
Senate Banking, Housing and Urban Affairs Committee
505 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Garn:

As you are well aware, the National Automobile Dealers Association (NADA) has long been concerned with high interest rates and the compounding problem of state usury ceilings. Beginning in late 1979 and continuing through 1981, franchised dealers across the country experienced the adverse effects of state usury laws.

During periods of high interest, financial institutions which are restricted by state usury ceilings either reduce significantly or stop altogether the financing of high ticket consumer items such as automobiles. The American Bankers Association, in testimony before a House Subcommittee on August 26, 1980, stated that " automobile dealers, despite aggressive marketing, were frustrated in their attempts to reduce high inventories due partially to the inability of consumers to obtain automobile loans." In many cases, the inability to charge the going rate, and not the credit worthiness of an individual, results in a refusal to extend credit.

When commercial banks get out of the auto financing business, a significant shift in the issuance of automobile paper from commercial banks to a manufacturer's finance company ensues. The liability for dealers when this situation occurs is twofold. First, some dealers do not have a finance company to turn to. Obviously, these dealers are placed in a critical situation. Even for dealers with access to a finance company, there are limits on the company's abilty to finance the ever increasing number of contracts being submitted to them. Second, withdrawal of financial institutions dilutes significantly the competitive atmosphere between the traditional providers of automobile financing.

NADA firmly believes that marketplace competition among all the traditional providers of automobile financing best benefits both franchised dealers and consumers. To this end, NADA supports the preemption of state usury laws as incorporated in S. 730. Should interest rates rise again to intolerable heights, the situation should not be aggrevated by artifical credit restrictions which only serve to harm both the consumer and the small business dealer.

NADA applauds your efforts to try and rectify the existing antiquated state usury law system and fully supports S. 730.

Sincerely,

William C. Turnbull

William C. Turnbull
President
National Automobile Dealers Association

WCT:ier

NCFC
NATIONAL COMMERCIAL
FINANCE CONFERENCE

ONE PENN PLAZA, NEW YORK, N.Y. 10001
(212) 594-3490

Chairman of the Board
Melvin E. Rubenstein
Rosenthal & Rosenthal, Inc.

President
Stephen C. Diamond
First National Bank of Chicago

First Vice President
Richard J. Dorgan
Wachovia Bank & Trust Co., N.A.

Vice President
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Vice President
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Associates Commercial Corp.

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William F. Plein
Commonwealth Financial Corp.

Treasurer
Gerald Blum
Trefoil Capital Corp.

General Counsel
A. Bruce Schimberg
Sidley & Austin

Executive Director
and Secretary
Leonard Machlis

April 8, 1983

Honorable Jake Garn
Chairman
Senate Committee on Banking Housing
and Urban Affairs
534 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Chairman Garn:

National Commercial Finance Conference (NCFC), the national trade association for the asset-based financial services industry, appreciates the opportunity to express our views on S. 730 the "Credit Deregulation and Availability Act of 1983." NCFC requests that these comments be made part of the hearing record.

The membership of the NCFC is made up of the asset-based lending arms of domestic and foreign commercial banks, independent finance companies, factoring organizations and financing subsidiaries of major industrial corporations whose chief business is to offer secured credit and factoring services to manufacturers, wholesalers, and retailers. While these borrowers are both large and small, the bulk of them are properly characterized as small and medium-sized business. Our industry is not engaged in consumer lending. Our membership runs the gamut in size from the asset-based financing divisions of large banks such as Security Pacific in California and First National Bank of Chicago, in Illinois to small privately held companies such as Puritan Finance Corporation in Illinois and Summa Capital Corporation in New York.

As a national association we have the particular ability to see how the myriad of rates imposed across the country negatively impact on the availability of credit for those who need it most. We, therefore, wish to state at the outset our support of S. 730 and urge its speedy consideration and passage.

We would like to provide you with some basic information on the average client of a member of the NCFC and the part our members play in keeping these clients a functioning part of the economy and to discuss the inequality of competitive positions among the states resulting from our current interest rate system.

The asset-based financial services industry provides funds to companies with annual sales ranging from as little as $250,000 to those with volume in excess of $100 million. The wide range in size of firms we finance clearly demonstrates the versatility of this financing technique. Furthermore, asset-based loans may be extended in amounts ranging from $50,000 to $50 million.

There is, frequently, no other ready source of funds for these companies who utilize the working capital lines of credit to expand their business. They frequently do not have access to traditional bank loans or the capital markets and, therefore, rely virtually exclusively on asset-based lenders.

Based on a 1980 survey, the asset-based financial services industry provided in excess of $32 billion in financing. Also, according to a 1982 survey, the financed clients of NCFC members provided over 650,000 jobs.

It is particularly crucial at this time when the rate of business failures is greater than any time in the last several decades to create an environment where creditors are able to offer the funds to enable business to grow, provide new jobs and assist in the much needed strengthening of the economy.

Ready capital is the basic requirement for this business growth, and small and medium size businesses, which can neither generate capital internally or borrow externally are the most severely hurt by a shortage of capital. The restrictive interest rate ceilings which exist in a number of states act to prevent creditors from making needed funds available. We have attached a chart which illustrates the wide variety of permissible rates which can be charged on corporate loans.

This particularly affects small corporate borrowers who do not have the ability to shop for credit on a nationwide basis. Indeed many states have a different ceiling for business loans in smaller or larger categories. Generally in these situations the more restrictive ceiling is placed on smaller amounts. The effect of this is to place smaller borrowers in a tighter credit situation than larger borrowers who usually have greater leverage. In New York State for example, the Superintendent of Banks' report to the legislature in 1981, pointed out that the exemption from the 25% criminal usury ceiling for loans of $2,500,000 or more is of no help at all to small companies whose borrowings do not exceed $2,500,000. In fact, the report specifically mentioned the clients of asset-based commercial lenders as among those borrowers who frequently fall outside the exemption because of the amounts financed.

Coupling this with the fact that during the recent period when the prime reached 21%, many of our smaller members were effectively estopped from doing business, results in a shortage of funds which has nothing less than a choking effect on new enterprise.

A Federal usury preemption as enunciated in S. 730 would permit the competitive forces of the marketplace to freely control the costs of borrowing funds for business purposes and would prevent a situation such as the one recently experienced where the prime rate came so close to the usury ceiling that borrowers, particularly small and medium size firms who have the most difficulty finding capital were effectively unable to obtain funds.

We wish to thank the Chairman and other members of the Committee for addressing this issue which is of major concern to our industry and to offer any assistance we might provide in your very worthwhile efforts.

Very truly yours,

Leonard Machlis
Executive Director

STP/sls
Enc.

Maximum Contract Rate on Corporate Loans

Alabama	N/L - loans in excess of $5,000.
Alaska	5% over discount rate under $100,000., N/L - loans in excess of $100,000.
Arizona	N/L
Arkansas	5% over discount rate
California	N/L
Colorado	45%
Connecticut	N/L - loans in excess of $10,000.
Delaware	N/L
D. C.	N/L - loans in excess of $1,000.
Florida	25%
Georgia	N/L - loans in excess of $3,000.
Hawaii	N/L - loans in excess of $750,000, 24% loans under $750,000.
Idaho	N/L
Illinois	N/L
Indiana	N/L
Iowa	N/L
Kansas	N/L
Kentucky	N/L - loans in excess of $15,000.
Louisiana	N/L
Maine	N/L
Maryland	N/L
Massachusetts	N/L - loans in excess of $6,000.
Michigan	25%
Minnesota	N/L
Mississippi	5% over discount rate through 6/30/84
Missouri	N/L
Montana	10% or 4% over discount rate for loans up to $150,000., non regulated lenders 10% or 5% over discount rate for loans between $150,000. and $300,000. non regulated lenders. N/L - loans in excess of $300,000. non regulated lenders N/L - loans by regulated lenders through 6/30/83
Nebraska	N/L
Nevada	N/L
New Hampshire	N/L
New Jersey	50%
New Mexico	N/L
New York	25%
North Carolina	N/L
North Dakota	5 1/2% plus rate on average 6-month Treasury Bills - non regulated lenders N/L - regulated lenders
Ohio	N/L
Oklahoma	45%

N/L equals no limit

Oregon	N/L
Pennsylvania	N/L
Rhode Island	21% loans under $25,000., 10% plus rate on 13 day Treasury Bills until 5/82 loans in excess of $25,000.
South Carolina	N/L if firm has more than $40,000. paid in capital
South Dakota	N/L regulated lenders
Tennessee	Lesser of 5% plus discount rate or 18%
Texas	28% loans in excess of $25,000. otherwise 24% or double the weekly or monthly average of 26 week U.S. Treasury bills
Utah	N/L
Vermont	N/L
Virginia	N/L
Washington	N/L
West Virginia	N/L
Wisconsin	N/L
Wyoming	N/L

The information above was taken from "The Current Status of Usury Legislation in the United States" by Susan W. Kramer and Glenn B. Canner, published in Issues in Bank Regulation/Summer 1982 except for state of Arkansas which was changed to reflect the November 1982 elections.

Posted Prime Rate Since 1933

October	1933	1.50%
January	1948	1.75
August	1948	2.00
Septebmer	1950	2.25
January	1951	2.50
October	1951	2.75
December	1951	3.00
April	1953	3.25
March	1954	3.00
August	1955	3.25
October	1955	3.50
April	1956	3.75
August	1956	4.00
August	1957	4.50
January	1958	4.00
April	1958	3.50
September	1958	4.00
May	1959	4.50
September	1959	5.00
August	1960	4.50
December	1965	5.00
March	1966	5.50
June	1966	5.75
August	1966	6.00
January	1967	5.75
March	1967	5.50
November	1967	6.00
April	1968	6.50
September	1968	6.25
December	1968	6.50
December	1968	6.75
January	1969	7.00
March	1969	7.50
June	1969	8.50
March	1970	8.00
September	1970	7.50
November	1970	7.25
November	1970	7.00%
December	1970	6.75
January	1971	6.50
January	1971	6.25
January	1971	6.00
February	1971	5.75
March	1971	5.50
March	1971	5.25
April	1971	5.50
July	1971	6.00
October	1971	5.75
November	1971	5.50
December	1971	5.25
January	1972	5.00
February	1972	4.75
March	1972	5.00
June	1972	5.25
August	1972	5.50
October	1972	5.75
January	1973	6.00
February	1973	6.25
March	1973	6.50
April	1973	6.75
May	1973	7.00
January	1974	8.75
March	1974	12.00
December	1974	10.50
March	1975	7.75
June	1975	7.00
December	1975	7.25
June	1976	6.75
December	1976	6.25
September	1977	7.00
December	1977	7.75
June	1978	9.00
September	1978	10.00
December	1978	11.25
June	1979	11.50%
December	1979	15.25
April 2	1980	20.00
May 2		18.50
May 30		14.00
June 6		13.00
July 4		12.00
July 18		11.50
August 1		10.75
August 15		11.00
September 5		11.50
September 19		12.50
October 3		13.50
October 17		14.00
November 7		15.50
November 21		17.00
December 5		19.00
December 12		20.00
December 19		21.50
January 9	1981	20.00
February 6		19.50
March 6		18.50
April 3		17.00
April 21		17.50
April 30		18.00
May 4		19.00
May 11		19.50
May 18		20.00
May 22		20.50
June 2		20.00
June 15		19.50
June 22		20.00
July 8		20.50
September 15		20.00
September 22		19.50
October 6		19.00
October 13		18.00
November 2		17.50
November 9		17.00
November 16		16.50

TESTIMONY BY INVITATION OF
THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

AND OF BEHALF OF MS. MAUREEN BLITHE, MS. GLADYS CHARLES AND OTHERS

by

The National Consumer Law Center, Inc.
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REGARDING S.730, PROVIDING FOR PREEMPTION OF CONSUMER CREDIT LAWS

April, 1983

I. INTRODUCTION

This statement is presented on behalf of several low-income people, concerned because the proposed Senate preemption of consumer usury statutes will deprive small borrowers of state-guaranteed consumer protection.[1]

Federal preemption of state consumer credit laws is unwanted, unnecessary, unwise, and unfair, moreso because of the overbreadth in Senate Bill 730.

State laws currently set limits not only on interest rates but on other credit terms such as the type of collateral that can be taken, variable rates, finance charges such as brokers fees, computations methods, attorney's fees, rebates, and refinancing terms. Like last-Session's S.1730, this bill will eliminate many of these important state consumer protection despite the contrary claims in the accompanying Analysis.[2]

Our clients, low-income people, are billed as the primary beneficiaries. In the experience of our clients and in our judgment, this is the case. They will not benefit as much as they will pay - in money and anguish. Deregulation does not make any borrowers better off.

Borrowers do not support this bill. No borrowers are asking for preemption. While we do not believe that the claims regarding availability are true, the more important fact may be that qualified borrowers want lower interest rates, not increased credit availability.[3] Congress is well aware of the great public anger over high interest rates. Senators must ask themselves whether borrowers will tolerate a new round of higher interest rates brought on by Congress, especially in view of the high negative rating Congress has earned on consumer issues.[4]

Of course, those who cannot qualify for credit, do want increased availability, and some may even be willing to pay higher interest rates to get it. But, as a December, 1982 Banking Department survey[5] of the effects of deregulation in New York shows, deregulation does not produce increased availability. So few New York lenders liberalized borrower qualifications that only the count for New York City commercial banks were even mentioned. And even there the institutions were 3:1 unchanged despite big rate increases. The fact is that lenders do not (and should not) lend to high risk borrowers with or without deregulation.

An analogy is helpful in explaining why borrowers do not want preemption. Unlike commercial borrowing, most consumer-lending only refinances existing consumer debt. As a result, increased rates are like increased rents: borrowers have to pay increases just to keep what they already have. And like rent increases, most interest rate increases are a windfall for lenders and does not represent new availability for borrowers. This seems particularly so in credit card markets where lenders are extracting more than their normal profit margins, by refusing to adopt a competitive market rate for consumers, now that the money market and the business prime rate have dropped.[6]

Consumer loan rates do not go down because competition over interest rates does not exist in many consumer credit markets. Just look around. Maybe price competition exists in the market for new car finance, but price competition does not exist in the market for most second mortgages, for used cars, or for credit cards. Many states which have "deregulated" have mistakenly assumed that pressure on interest rates in one credit market implies competition in other markets. The used car market in Chicago shows how little competition the "free market" provides. A recent article in the Chicago Tribune reports used car loans costing more than 50% per annum. A 48% loan from Chicago is attached.

Preemption was supposed to ease practical restrictions on interstate lending and to ease the upward pressure against interest rates ceilings. Both economic changes and state and federal legislative action has met the concerns.

Senate 730 dismantles structural controls that prevent many of the "demons of the 1930's", that the original government regulation of credit was designed to exorcise.[7] This bill will clear the way for exotic and dangerous forms of unlimited and uncontrolled "creative finance". It is not just interest rate gouging that is being legalized here.

The recent second mortgage scam in Baltimore is one example of the kind of abuses fully legalized if the bill is enacted. There borrowers were tricked into paying both 24% interest rates and 40% of the nominal loan amount as loan arranger's fees. These credit costs were not disclosed or properly characterized. The Attorney General was able to protect the borrower under existing Maryland law.[8] If S.730 had been in effect, the high, undisclosed rates would have been legal. Moreover state limits on interest and loan-arranger's fees would have been preempted. After preemption, countless states like Maryland will find that the interest and interest--linked limitations, such as limits on "broker" fees (including those in states without usury ceilings, like Illinois) are meaningless.

This creative financing is frequently bad for consumers. Variable rates, negative amortization, and second mortgages securing car financing provide benefits for lenders but they often bring great harm to consumers. The results from limited state experimentation with such creative financing are slowly becoming more obvious nationwide.

Disclosure laws do not protect consumers, especially in today's already deregulated credit market. Loopholes in the Truth-in-Lending Act allow many lenders to disguise the true cost of consumer credit, particularly variable rate debt and sellers points.[9] What appears to be low interest costs is often in fact very expensive credit. The TIL act has legalized certain endemic misrepresentation and allowed creditors who take advantage of that misrepresentation to earn higher profits than those who do not misrepresent. This bill enlarges such abuse.

II. PREEMPTION IS UNNECESSARY AND OVERBROAD

Economic changes and state and federal legislative action have eased practical restrictions on interstate lending and upward pressure against interest rates ceilings. Federal preemption, the most favored lender doctrine, and Marquette Nat'l Bank v. First of Omaha Service Corp.[10] (allowing exporting of interest rates) remove the practical restrictions presented by state usury laws on interstate lending. Since 1981 more than 40 states have eliminated or lifted interest rate ceilings.[11] In addition, other federal legislation has preempted state interest rates on first mortgages and home lending - together a huge percentage of consumer borrowing.[12] The only competitive area of lending unaffected by federal legislation, that of new car finance,[13] is not regulated in many states. In others, that state ceilings are well above existing market rates. The high prime rate has gone done. The original reasons for preemption have been met.

S.730 preempts much more state law than necessary to achieve the proponents' aims of increased lending and higher rates. Be seeking to preempt all law which "in any way limits" the manner of "provioing or contracting for covered charges [or any similar] compensation", this bill would presumptively eliminate virtually all laws restricting consumer credit contracting.

Laudable state consumer protections which the Analysis claims to have retained are actually swept away by broad language. These protections are not otherwise preserved by the bill's saving language or the licensing provisions. For example, the Analysis claims that under this bill a state can prohibit real estate lending on loans costing more than 18%. In fact, a state cannot.[14] The bill preempts all laws "in any way limiting the . . . manner of . . . providing or contracting for covered charges"[15] such as interest, and covers all lending "without regard to the nature of any property that might secure its repayment."[16] A state law prohibiting rates of more than 18% on real estate loans is a law limiting the manner of contracting for covered charges. Therefore, it would be preempted. The Analysis is incorrect in this regard. Virtually all claims in the Analysis to preserve consumer protection" sections are incorrect for the same reason.[17]

III. "DEREGULATION" AND HIGH RATES DO NOT REDUCE CREDIT QUALIFICATIONS

We can already see that the competition promised us does not bring down consumer interest rates, despite the announced economic theory. If there were sufficient interest-rate competition, consumer interest rates would have dropped sharply from their 1982 levels. The cost of borrowed funds has dropped sharply.[18] Consumer interest rates have not.[19] Continued high consumer rates in the face of a much reduced money market show the inadequancies of competition. It is incredible that lenders continue to argue that deregulation would move rates downward, when the opposite persistently proves to be true.

That deregulation does not improve availability is demonstrated in the December 1982 study, "The Price and Availability of Consumer Credit in New York State", by the New York State Department of Banking. Despite the severe methodological shortcomings[20] in this unsystematic survey[21], the failure of the New York experiment in deregulation to significantly improve credit availability is striking.

Increased credit availability can be measured by a reduction in the qualifications for obtaining credit so that people denied credit can now obtain it or by an increase in the amount of credit to existing borrowers. Neither occurred in New York following deregulation of rates in that state. Only a minority of commercial banks in New York City are reported to have eased credit terms, either to new borrowers (described in the Survey as "increasing lines of credit") or to those who could not get credit before (described as "liberalizing" their "borrower qualifications").

Ninety-three percent (93%) of commercial banks raised interest rates but refused to reduce new-borrower qualifications. 83% refused to offer better terms to existing-borrowers.[22] For other lenders no specific numbers were provided, but "most" savings banks had "not liberalized" either measure of credit availability.[23] "Only a few" of the 95 savings and loans had liberalized credit availability.[24] "Most" of the 105 New York credit unions had not changed their credit availability.[25] "Most" of the 38 finance companies have not changed their qualifications though they have raised their rates as far as they legally can.[26] "Virtually all" of the 80 retailers in New York have kept credit availability unchanged.[27] A "preponderance" of the 268 auto dealers in New York have also raised interest rates since deregulation, but not changed their credit qualifications.[28] The New York survey presents a dismal demonstration of deregulation's "benefits". For the most part, the higher interest rates have brought almost no new credit.

The report ignores these results and focuses on undefined "participation", which has increased. Apparently, participation increases when lenders offer to make loans of types they had not before - as did the S & Ls after consumer lending was authorized. Since borrower qualifications are not reduced, this means that only a borrower who qualified before qualifies with an additional lender. This does not mean more money. And those who could not qualify before still cannot.

This lack of increased availability following deregulation may be national. It certainly is true that the notion that credit availability will improve is contrary to common sense: higher "prices" deter borrowers who have the option to wait. Higher prices also imply increased borrower qualifications, since the higher debt-service cost puts a greater strain on disposable borrower income. Hypothetically, increased interest rates should deter borrowers, not improve credit availability.

The New York survey also demonstrates the other result of deregulation. Deregulation allows lenders to charge more for the same dollars. Borrower qualifications are as harsh as ever plus the interest costs have increased. For example, in New York, interest rates on credit cards jumped from 16% to 19.8%. (Membership fees makes the true cost of credit higher.) Extending this pattern (including fees) to the

66 billion dollars of revolving credit in the United States,[29] then the usury preemption proposed in S.730 would cost consumers $8,186,700,000.00 additional dollars on revolving credit alone.[30] (And revolving credit is barely 20% of non-mortgage consumer debt.) This is a 70% increase in finance charges.

IV. LENDER APOLOGIES FOR HIGH CONSUMER INTEREST RATES ARE NOT CREDIBLE

Lenders have offered four major excuses for the high interest rate side of this inequity. Those excuses are inflationary expectation, risk, cost of funds, and recoupment of past losses.[31] The first reason makes little sense because there has been little inflation over the last year. Whether there will be in the future is unclear. What is clear is that the lenders' prophecy can become self-fulfilling. Actions by lenders increasing interest rates will help produce the inflation they predict. The risk excuse implies that future lending risks will be are many times greater than they were two years ago. Risk would be greater only if the future climate made lending more risky or lenders lent to a class of borrowers constituting higher risks. Neither reason exists. The fact that interst rates on commercial lending have come down with the decreasing prime rate suggests that the future climate is not more risky.[32] And, as the New York survey demonstrates, riskier borrowers are not served. Reduced qualifications did not follow for perhaps 840 of the 900 lending institutions in New York.[33]

A third excuse for persistent high interest rates, the high cost of funds, also falls under scrutiny. Lenders allege that their funds available for lending used to come from passbook accounts costing 5% but not come from money market funds cost 8%.[34] In fact, most funds used to come from large certificates of deposit (CDs).[35] They now come from money market funds which are cheaper than CDs, so the cost of borrowed funds has gone down.[36]

The last excuse lenders make is the recoupment of past losses. Existing borrowers, who qualified for credit under the old rates, must now pay a higher interest rate on refinancings so that lenders can recoup past losses. Not only is it unfair to make current borrowers pay for past losses, the power of lenders to force borrowers to pay for this demonstrates the fallacy of competition in most consumer credit markets. This inequity is a measure of lack of competitive benefit to hapless borrowers. Although major lenders could compete on interest rates, they prefer an "informal agreement" not to cut consumer credit "price", in order to recoup past losses, as the industry puts it.

There remain two possibilities, apart from profit-taking, that might explain high consumer interest rates. First, credit card frauds are increasing markedly, as organized crime and mass production methods are coming into vogue with counterfeiters. Some institution's costs are doubtless up because credit cards are easy to fake, and with merchant collusion, existing authorization systems are too old-fashioned to prevent losses. Until preemption alters the contracting powers of lenders, those losses cannot be imposed on the immediate victims, so they are paid by borrowers instead of by the bank's owners.

Banks are also altering their geographic locations and methods of doing business. These changes generate large losses (as branches are closed) and special expenses (as new business ventures are begun). Lack of competition allows lenders to do this.

V. Uncontrolled Consumer Credit Hurts Borrowers and Everyone Else

One need only look at the new car markets in this country to realize the price paid by the entire economy for high-cost credit and for unregulated "creative" financing. Of course, high interest rates have deterred many car buyers, since the vehicle is rendered unaffordable by its financing terms. In time, fewer borrowers will be fooled any longer by the low-seeming interest rates offered by dealers and some captive finance companies, as they grow to understand the cash-price subsidies that make many automobile interest rates deceptively low.[37]

A great many consumer credit markets are non-competitive too. The city of Chicago, for example, is now reporting used car interest rates in excess of 50% APR. Here lenders in search of higher profits are using the loansharking techniques recently legalized in Illinois to pray upon the unsophisticated, inner-city dweller. One finds no comfort whatsoever that the affluent suburbanites have seen only moderate increases on their credit cards and second mortgages. Similarly, the active competition for the affluent borrower by non-banking institutions such as stock brokers, is immaterial to the small farmer or working person, untouched by new competition. Indeed, it may be that deregulation has liberalized consumer funds to a point that certain markets are relatively disadvantaged after interest rates are lifted.

Credit markets are not the same as buyer and seller bargains for the sale of goods. Unlike buying soap, credit "sellers" with cash available will not loan to every borrower who is willing to "pay the price". There are always those who are economically or objectively unqualified to borrow more than they are current carrying. Even if the over-extended borrower wishes to pay high prices for further debt, rational lenders will not offer credit to those who are unqualified by reason of over-extension or other high risks. Unlike soap prices, interest rates (and risk premiums) cannot continue to escalate indefinitely. And increasing interest charges directly decrease borrower qualification: the higher the risk premium, the better qualified the borrower must be to afford it.

Consider the systematic departure of most national finance companies from the small loan markets for which their high rates were originally legalized. In the past, legislative limits on real estate collateral and other abuses prevented harmful exotic financing arrangements. As a result, capital was attracted into small loan markets because profit margins were relatively attractive. As interest rates in second mortgage lending increased, finance companies and other enders found it far more attractive to lend to home owners. As a result, there is less money available for borrowers who do not own homes. Deregulation has largely dismantled that balance between the interests of different borrowers. Inner-city dwellers must now pay 40% or 50% APR or do without credit altogether.[38]

Borrowers are also beginning to realize that automobile financing is no longer limited to its old, reliable forms, and contracts may involve legal "landmines" that were previously unthinkable. In many deregulated states, borrowers have given second mortgages as collateral on automobile loans, or signed variable-rate automobile notes. They are now discovering to their horror the costs and risks they've accepted.

Their reliance on the TILA and state consumer protections laws to protect them was misplaced. The resulting defaults and bankruptcies make the market dangerously unworkable.

And information in credit markets is often terribly incomplete, especially as the Truth-in-Lending does not describe creative financing properly, and various forms of deregulation permit legalized misrepresentations that were heretofore unknown. A bar of soap today is essentially the same as a bar of soap was two years ago, so that buyer can evaluate the price-value relationship when making new soap purchases. But a car loan today is legally unlike car loans in 1981, because a variety of abuses which used to be illegal have since been permitted again. As a result, buyers should not assumed the credit-contract is the same, as before. Many do, to their later disappointment and expense. Unfortunately, the state disclosure laws and the federal Truth-in-Lending Act have failed to keep pace or show many of these differences to borrowers. At all levels, Financial regulators have utterly failed to standardize terminology or price calculations, so that there is no practical way to realize the crucial differences between these new instruments and the old contracts.

These market inadequacies also mean that there is no practical way to compete for those few lenders that do wish to offer their borrowers honest value, since the borrowers are virtually prevented from shopping by the mish-mash incomparable information that is provided even in crucial transactions, such as home purchase finance. The better lenders cannot compete with legalized unfairness that deregulation and preemption bring.

VI. CONCLUSION

Those who understand the borrowers' need would delay further federal preemption in order to preserve the important state role in credit protection and to study the massive preemption already undertaken. To the extent that information is available, there seem to be deep problems in submarkets like Chicago, a general failure of the promise of improved availability, which justified the original deregulation experiment in New York. And rates do not follow the money market.

It is crucial to study this subject in a more systematic way and we urge the Senate to impanel a new National Commission on Consumer Finance in order to study and recommend the future course of federal intervention in state consumer credit law. We earnestly believe that the existing deregulation experiments in the majority of the states involve varying degrees of judgment, which needs time to be understood.

It is also a terrible market risk to preempt state credit markets further, because of the turmoil and commercial expense that that creates. If the many million dollars of costs associated with lender compliance with new Regulation Z are typical, the lending industry frequently miscalculates the costs it faces as it asks for the law to be changed. Had borrower requests to leave Truth-in-Lending unsimplified been followed, hundreds of millions of dollars would also have been saved, and borrowers would have better quality information with which to evaluate the new lending arrangements they must use.

Because shopping information is so poor and so many consumer credit markets are so lacking in competition, any preemption effort must include systematic inprovements in the credit costs disclosure laws, and a comprehensive federal consumer credit protection law. We recommend the adoption of the Wisconsin Consumer Act, as the federal prerequisite of any further consumer usury preemption.

We also think that amendments are needed to insure that the bill preserves those consumer protections which the Analysis now falsely claims the bill preserves. One such amendement would be to preempt only charges viewed as finance charge under the Truth-in-Lending Act. Such limited preemption would wreak far less damage to state law than the proposed bill.

1 The author of this statement, the National Consumer Law Center, Inc. ("NCLC") was established in 1969 to render legal and expert assistance and support on consumer credit protection laws and other consumer matters to the more than 6,000 attorneys who provide legal assistance to low-income people through programs funded under the Legal Services Corporation.

2 See Part VI and Note 20 suggest specific amendments to implement the consumer protection intent expressed in the Analysis but missing in the bill.

3 Federal Reserve Board, Consumer Advisory Council Newsletter, Page 18 (March/April, 1983).

4 New York Times, 2/17/83 at A15.

5 Discussed in Part II.

6 See Parts II and III. Even some Federal Reserve bankers think interest rates are too high. See 4/5/83 Wall Street Journal at 3.

7 The observation was made by an unnamed "financial sage", who was reported to have observed that the deregulation of consumer credit amounted to a rapid reinvention of many of the lending patterns which caused such woe during the Great Depression. See Cullhane, Variable Rate Credit, 37 The Business Lawyer, 1293 (1982).

8 Washington Financial Reports, April 4, 1983, at 179. The arrangers were recently exempted from the Truth-in-Lending Act by Congress. As a result, borrowers receive no TILA disclosure of such transactions.

9 See 15 U.S.C. § 1601 et. seq. (1980) and Regulation Z, 12 C.F.R Part 226 (1981). The TILA requires only that the initial interest rate under a variable rate note need be disclosed. As a result, borrowers do not realize how quickly rates can go up or that the rate can be increased on old extensions rather than just on future extensions.

10 439 U.S.C 299 (1978).

11 Financial Publishing Company, Cost of Personal Borrowing in the United States (1981 and 1982).

12 It is implemented through Title VIII of the 1982 Depository Institutions Act.

13 Even Arkansas now allows 17% consumer debt.

14 See Congressional Record, S2334 (bottom of first column) (March 8, 1983).

15 S.730's new § 731 to Title V of 1980 Depository Institutions Deregulation and Monetary Control Act.

16 S.730's new § 532(a)(2) (defining "credit"), to be added to Title V of the Depository Institutions Deregulation and Monetory Control Act of 1980.

17 The New York study is unsystematic, see note 21 below. But it also distorts the limited information gathered by over-generalizing. It suffers from low response rates for major institutional types, and no effort was made to determine whether the bias in those who reported was where there was something "good" (lower interest rates, liberalized credit qualification), so that the sample used underestimates the harsh impact(s).

Simple averages are used, so that Citibank's 19% used car APR is equally weighted with Bank of New York's 14.5% APR, even though the former is 840% the size of the latter, with perhaps 8 times more auto-loan borrowers. The simple average of these two APRs is 16.75%, but when size is taken into account the weighted average is a more representative 18.52%. In this way, the charts on "average" rates understate the likely cost of credit in New York. Moreover, wherever possible, the lowest available rate was chosen, such as the one-year old car financed by an existing bank customer, where the simple-average rare is for the nine reporting banks in November 1982 is 17.5%, while the market for used cars is dominated by cars 2 years old and more financed by new borrowers, for whom the average rate is 19.19% APR. See Table 8, but compare Chart 5 which omits this result.

Important credit costs are ignored in the Charts, primarily the additional fees added to most credit cards and the use of interest-prepayment "points" in second mortgages. When the points added by New York City banks are included in the APRs (as they should be, but were not by the Banking Department), a 15.5% rate becomes a more accurate 16.87%. The use of averages without this adjustment means the costs of second mortgages and credit cards are understated.

No attempt is made to weight the costs by measures of market size either, so it is impossible to appreciate whether the lower rates of some commercial banks upstate are important market effects, or only small influences on a state market dominated by other institutions.

18 See the March 17, 1983 testimony (p. 2) of Glenn Nishimura on bhealf of Consumer Federation of America before the Consumer Subcommittee of this Committee.

19 Id.

20 The Analysis that suggests preemption "does not extend to state consumer protection laws that deal with restrictions, limitations, and prohibition against certain types of credit activity which are unrelated to enumerated charges assessed in connection with a credit transaction" can be easily misunderstood. That statement is true only in an extremely narrow sense. In situations of doubt, the overbroad preemption language appears to override most state provisions in this category, including most of the examples specifically in the Analysis as preserved from this federal interference. The following nine examples are typical of the mismatch between announced intent and legislative language, a problem which has persisted since the 1981 revisions.

20.1 Rescission rights, like most consumer credit protections, can be evaded by this preemption. Apart from federal law, state rescission rights in door-to-door sales laws, for example, apply because loans are written pursuant to a specific state statute, and are not generally available. Therefore, lenders who wish to avoid granting rescission rights do so by operating under another statute. In most situations these specialized usury statutes are *not* mandatory, but permissive; in return for legalizing high interest rates, lenders agreed to conform to consumer protections not required under the general usury laws. Where the general usury ceiling is preempted, many lenders no longer need to do business under the statute which contained consumer protection, since whatever rate they wish to choose may now be levied pursuant to a loan under the general usury statutes which have no consumer protections in them. Licensing as a device to impose such protections is the exception.

Lenders obliged to continue under a mandatory rescission statute still do not need further legalization of their credit practices to avoid rescission. Under preemption already in place "housing creditors" within the meaning of the meaning of the 1982 Depository Institutions Act, need respect only those rescission rights binding on federally-regulated depositories. Under the new Federal Home Loan Bank Board Regulations, for example, *See* Noticed Housing Creditors Regarding Alternative Mortgage Transactions, 47 F.R. 15733 (November 17, 1982) at 51734. "For all other residential real property loans, housing creditors that are not commercial banks, credit unions or federal associations are authorized to enter into alternative mortgage transactions without restriction on adjustments to rate, payment, balance for term *and without required disclosure*" (emphasis added). Because federal associations are bound only by the Truth-in-Lending decision rules, state prohibitions against the use of real property security to collateralize a credit sale may already be overridden; certainly there are lenders who will argue that any disclosure of any rights to rescind has been preempted by the language quoted above.

If the proposed preemption becomes law, the text preempting any limitation on the contracting for covered charges, overrides that protection, since by operation of state law penalties or even voiding of the contract result if the rescission is not provided. That overbroad language could be removed, and a specific preservation of rescission rights would also be in order (perhaps by defining "creditor" as only those who comply with such provisions, if applicable, to any lender in the jurisdiction.

20.2 The Analysis also improperly suggests that laws limiting attorney's fees would continue to apply, when in practice they might not. As above, attorney's fees also are regulated on a statute-by-statute basis and are typically not generally limited in consumer transactions, but only by special consumer usury statutes. As a result lenders operating under the general usury laws without ceilings need not respect statutory limitations on attorney's fees. Fees payable to the creditor for attorneys' expenses are preempted as "compensation paid to the creditor and arising out of the credit agreement or transaction". Inasmuch as attorney expenses in collection may not arise "soley" as the result of the default of the debtor, the attorney's fees limitation is not preserved by that saving language. Technically a contract with an additional precondition to attorney's fees liability (such as a judgment) would fall outside the of the saving language, and thus be preempted. Even assuming the proposed language was redrafted in order to preserve any charge arising in part or related to such a default, preemption might still apply because attorney's fees liability arise under common law or statute independent of the "debtors agreement". Certainly there will be lenders claiming illegal attorney's fees who will excuse their act by asserting those state provisions to have been preempted; explicit amendments will be necessary to avoid this ambiguity when Congress occupies the field.

20.3 It remains to be seen whether laws limiting charges that may be assessed for resolving errors avoid preemption, since those charges are also "compensation paid to the creditor arising from the transaction for the use of credit or credit services", and as errors do not arise from any default of the contract by the debtor. Again an explicit amendment would ne necessary would be necessary to avoid this result, the misleading Analysis notwithstanding.

20.4 The misstatement in the Analysis respecting the continuance of a maximum rate for real property lending appears in the main text. State law prohibiting collection activities on high- rate transactions has exactly the same likelihood that it too will be preempted by the plain language of the proposal. Consider a bar on wage-assignments which might appears under the small loan law. If that small loan law was not mandatory, then small lenders could avoid the wage assignment on debt collection by using the general usury statute instead. A licensed lender who is forced to observe such a provision would still have available the argument that such a bar was a limitation on the manner of contracting for high interest rates, and thus preempted by proposed section 531. It is appropriate that such preemptions not occur, but the Drafters' intent as announced in the Analysis is not observed in the proposed text. Again the preemption of "any limit on the manner of contracting" should be excised, and the specific preservation of debt collection protections made explicit.

20.5 State laws that restrict rebate rules in the event of prepayment of precomputed charges are also at risk of preemption in the proposed text, even though that is not the announced intent according to the Analysis. Precomputed interest is clearly a "covered charge" which may be "received" in the form of a prepayment, should a borrower wish to terminate the loan obligation early. To the extent that a state statute requires a rebate in this situation it is explicitly limiting the amount of a covered charge that may be received, and thus preempted. As a result the preservation of rebate protections requires an explicit amendment, perhaps in the form of narrowing the definition of covered charges to those which have been earned pursuant to an actuarial rule.

20.6 Prohibitions of prepayment penalties avoid preemption in a few circumstances, but are not broadly preserved as the Analysis suggests. Assuming the lender has no option but to follow the statute containing a prohibition on such penalties, the penalty would certainly be a form of compensation paid to the creditor and arising from the transaction, so that the state language is limitation on a covered charge generally preempted. It falls within the saving language for default charges only if the penalty arises soley from a failure to comply with the terms of the contract, which is not the case in an orderly prepayment period. Again, specific amendments would be needed to avoid preemption beyond that which the Drafters intend.

20.7 Requirements that contracts use plain English ought to avoid preemption, but it depends on the statutory mechanism. In cases of variable rate credit, for example, the statute which permits this style of lending may require disclosures that are comprehensible, much as do the federal regulations on the subject. A contract lacking plain language is presumed by such a rule of law to lack mutuality, and might nullify the contract aben itio. Were this the rule, such a provision becomes an obvious limit on the manner of contracting for covered charges, since they cannot be contracted for if this limitation is not observed. To avoid preempting these provisions, the operative of proposed § 531 must be narrowed, and an explicit preservation implemented, as well.

20.8 The same sort of mismatch between the Drafters' intent and the scope of this overbroad statute occur in virtually all the remaining example proposed by the Analysis. In virtually all instances the sweeping preemption in the bill's text overrides the state law provisions which the Analysis hopes will remain in place. Even the licensing mechanism is weak, since many states use systems other than formal licensing to link consumer protections to loans. In Massachusetts there is a 20% usury ceiling for non-financial institutions, which must be observed unless the Attorney General is formally notified. This notice requirement a form of licensing, and so does not carry with it the preservations in the proposed definition of preemption-benefited creditor. This notification requirement is thus apparently preempted, thus legalizing criminal loan sharking in the Commonwealth.

20.9 Finally, consider the ambiguity regarding state insurance regulations limiting permissible rates of credit insurance premiums. The Drafters intend that these regulatory powers remain in place, but have not written their preemption to avoid overriding this mechanism too. Credit insurance is doubtless a credit service arising out of the credit agreement, and the commission and expenses paid to the creditor as insurance agent are compensation within the meaning of "covered charges" even if other portions of the premium are not. At least to that extent, the plain language of the proposed preemption overrules any state power to limit the level of that compensation. To view the language otherwise would require the proposed § 531 be narrowed and the definition of covered charges substantially restricted from its present form.

21 The use, and emphasis of November, 1982 statistics is extremely misleading, as it includes a small number of institutions with no measure of the adequacy of such a seemingly distortionate approach. Even the initial sampling was doubtful as to retailers and auto-dealers:

	September	November
Commercial Banks	160/222 = 72%	23/222 = 10.4%
Savings Banks	92/98 = 93.9%	6/98 = 6.1%
Savings & Loans	65/95 = 68.4%	6/95 = 6.3%
Credit Unions	54/105 = 51.4%	6/105 = 5.7%
Finance Companies	31/38 = 81.5%	4/38 = 10.5%
Retailers	15/80 = 18.75%	6/80 = 7.5%
Auto Dealers	58/260 = 22.3%	7/260 = 2.7%

22 Kohn, Carlo and Kaye, "The Price and Availability of Consumer Credit in New York State" (New York State Banking Department, December 1982), at 12, called "New York Credit Availability" hereafter.

23 New York Credit Availability at 40-41.

24 New York Credit Availability at 49.

25 New York Credit availability at 57.

26 New York Credit Availability at 63.

27 New York Credit Availability at 67.

28 New York Credit Availability at 70.

29 From Consumer Installment Credit, Chart 1.56, Federal Reserve Bulletin, page A-42 (February 1983).

29 Two example contracts as attached as Appendix I.

30 On the conservative assumption that revolving debts can be repaid in 24 months without further rate increases or additional debt, 66 billion dollars at 16% APR cost $11.557 billion in finance charges, which increases to $14.464 billion at 19.8% APR. Adding 2 years of extra $20 fees on 264 million accounts is another $5,280,000.00. The estimate assumes an average balance of $500 and that 50% of cardholders pay in full every month.

31 American Financial Services Association, Credit Week (March 24, 1983).

32 _See_ the cost of funds chart at Appendix I hereafter.

33 New York Credit Availability Study, _supra_ note 22.

34 _Supra_, note 18, at p. 3.

35 _Supra_, note 18 p. 10-11.

36 Flannery, "Removing Deposit Rate Ceilings: How Will Bank Profits Fare?", Business Review (FRB of Philadelphia, March/April 1983) 13 at 15. In this study, Professor Flannery, an academic advisor to the Philadelphia Federal Reserve Board, described the "fallacy" of the view that Regulation Q, or deposit-side, deregulation would be passed along, as he observes

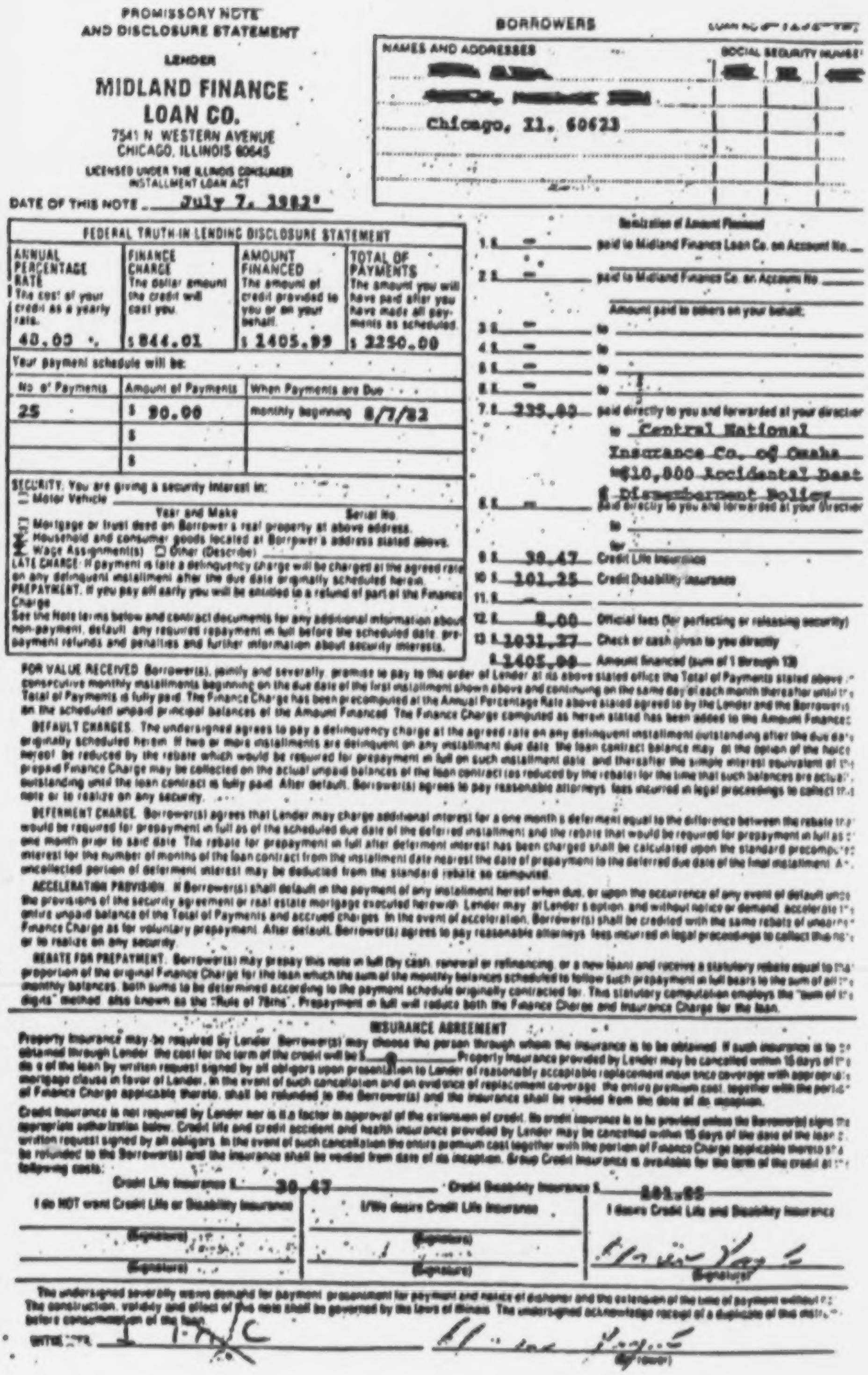
> "...basic economic analysis indicates that higher loan rates will tend to reduce the dollar value of loans on banks' books. If bankers could increase total loan revenues by raising rates, why would they not have done it already? Despite much research on the subject, there is no pursuasive evidence that Regulation Z ceilings affect the loan rate at all."

He observes that commercial transactions have not been affected by deregulation, and notes that "borrowers are always free to go to nonbank lenders who would not be affected at all by Regulation Q ceilings", if deposit rate deregulation were to have the effect claimed.

37 Seller pre-paid financing, for example, permits dealers to advertise cheap-seeming interest rates through the device of increased car prices, a glaring loophole that the Federal Reserve Board has refused to correct. Federal Reserve Board Staff recommended a return to the original form of Regulation Z which prevented this distortion, but the Board majority refused to act, forcing even legitimate car financers to meet the competition by adopting deceptive practice.

38 Two example contracts are attached as Appendix I.

APPENDIX I



PROMISSORY NOTE
AND DISCLOSURE STATEMENT

LENDER

MIDLAND FINANCE
LOAN CO.
7541 N. WESTERN AVENUE
CHICAGO, ILLINOIS 60645

LICENSED UNDER THE ILLINOIS CONSUMER INSTALLMENT LOAN ACT

DATE OF THIS NOTE July 7, 1982

BORROWERS LOAN NO. [illegible]

NAMES AND ADDRESSES	SOCIAL SECURITY NUMBER		
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]			
Chicago, Il. 60623			

FEDERAL TRUTH-IN-LENDING DISCLOSURE STATEMENT

ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate.	FINANCE CHARGE The dollar amount the credit will cost you.	AMOUNT FINANCED The amount of credit provided to you or on your behalf.	TOTAL OF PAYMENTS The amount you will have paid after you have made all payments as scheduled.
40.03 %	$ 844.01	$ 1405.99	$ 2250.00

Your payment schedule will be:

No. of Payments	Amount of Payments	When Payments are Due
25	$ 90.00	monthly beginning 8/7/82
	$	
	$	

SECURITY: You are giving a security interest in:
☐ Motor Vehicle ______ Year and Make ______ Serial No.
☐ Mortgage or trust deed on Borrower's real property at above address.
☒ Household and consumer goods located at Borrower's address stated above.
☒ Wage Assignment(s) ☐ Other (Describe) ______

LATE CHARGE: If payment is late a delinquency charge will be charged at the agreed rate on any delinquent installment after the due date originally scheduled herein.

PREPAYMENT: If you pay off early you will be entitled to a refund of part of the Finance Charge.

See the Note terms below and contract documents for any additional information about non-payment, default, any required repayment in full before the scheduled date, prepayment refunds and penalties and further information about security interests.

Itemization of Amount Financed

1. $ — paid to Midland Finance Loan Co. on Account No. ______
2. $ — paid to Midland Finance Co. on Account No. ______

Amount paid to others on your behalf:

3. $ — to ______
4. $ — to ______
5. $ — to ______
6. $ — to ______
7. $ 235.00 paid directly to you and forwarded at your direction to Central National Insurance Co. of Omaha for $10,000 Accidental Death & Dismemberment Policy
8. $ — paid directly to you and forwarded at your direction to ______ for ______
9. $ 30.47 Credit Life Insurance
10. $ 101.25 Credit Disability Insurance
11. $ — ______
12. $ 8.00 Official fees (for perfecting or releasing security)
13. $ 1031.27 Check or cash given to you directly

$ 1405.99 Amount financed (sum of 1 through 13)

FOR VALUE RECEIVED Borrower(s), jointly and severally, promise to pay to the order of Lender at its above stated office the Total of Payments stated above in consecutive monthly installments beginning on the due date of the first installment shown above and continuing on the same day of each month thereafter until the Total of Payments is fully paid. The Finance Charge has been precomputed at the Annual Percentage Rate above stated agreed to by the Lender and the Borrower(s) on the scheduled unpaid principal balances of the Amount Financed. The Finance Charge computed as herein stated has been added to the Amount Financed.

DEFAULT CHARGES. The undersigned agrees to pay a delinquency charge at the agreed rate on any delinquent installment outstanding after the due date originally scheduled herein. If two or more installments are delinquent on any installment due date, the loan contract balance may, at the option of the holder hereof, be reduced by the rebate which would be required for prepayment in full on such installment date, and thereafter the simple interest equivalent of the prepaid Finance Charge may be collected on the actual unpaid balances of the loan contract (as reduced by the rebate) for the time that such balances are actually outstanding until the loan contract is fully paid. After default, Borrower(s) agrees to pay reasonable attorneys' fees incurred in legal proceedings to collect this note or to realize on any security.

DEFERMENT CHARGE. Borrower(s) agrees that Lender may charge additional interest for a one month's deferment equal to the difference between the rebate that would be required for prepayment in full as of the scheduled due date of the deferred installment and the rebate that would be required for prepayment in full as of one month prior to said date. The rebate for prepayment in full after deferment interest has been charged shall be calculated upon the standard precomputed interest for the number of months of the loan contract from the installment date nearest the date of prepayment to the deferred due date of the final installment. Any uncollected portion of deferment interest may be deducted from the standard rebate so computed.

ACCELERATION PROVISION. If Borrower(s) shall default in the payment of any installment hereof when due, or upon the occurrence of any event of default under the provisions of the security agreement or real estate mortgage executed herewith, Lender may, at Lender's option, and without notice or demand, accelerate the entire unpaid balance of the Total of Payments and accrued charges. In the event of acceleration, Borrower(s) shall be credited with the same rebate of unearned Finance Charge as for voluntary prepayment. After default, Borrower(s) agrees to pay reasonable attorneys' fees incurred in legal proceedings to collect this note or to realize on any security.

REBATE FOR PREPAYMENT. Borrower(s) may prepay this note in full (by cash, renewal or refinancing, or a new loan) and receive a statutory rebate equal to that proportion of the original Finance Charge for the loan which the sum of the monthly balances scheduled to follow such prepayment in full bears to the sum of all the monthly balances, both sums to be determined according to the payment schedule originally contracted for. This statutory computation employs the "sum of the digits" method, also known as the "Rule of 78ths". Prepayment in full will reduce both the Finance Charge and Insurance Charge for the loan.

INSURANCE AGREEMENT

Property insurance may be required by Lender. Borrower(s) may choose the person through whom the insurance is to be obtained. If such insurance is to be obtained through Lender, the cost for the term of the credit will be $ — . Property insurance provided by Lender may be cancelled within 15 days of the date of the loan by written request signed by all obligors upon presentation to Lender of reasonably acceptable replacement insurance coverage with appropriate mortgage clause in favor of Lender. In the event of such cancellation and on evidence of replacement coverage, the entire premium cost, together with the portion of Finance Charge applicable thereto, shall be refunded to the Borrower(s) and the insurance shall be voided from the date of its inception.

Credit insurance is not required by Lender nor is it a factor in approval of the extension of credit. No credit insurance is to be provided unless the Borrower(s) signs the appropriate authorization below. Credit life and credit accident and health insurance provided by Lender may be cancelled within 15 days of the date of the loan by written request signed by all obligors. In the event of such cancellation the entire premium cost together with the portion of Finance Charge applicable thereto shall be refunded to the Borrower(s) and the insurance shall be voided from date of its inception. Group Credit Insurance is available for the term of the credit at the following costs:

Credit Life Insurance $ 30.47 Credit Disability Insurance $ 101.25

I do NOT want Credit Life or Disability Insurance	I/We desire Credit Life Insurance	I desire Credit Life and Disability Insurance
(Signature) (Signature)	(Signature) (Signature)	(Signature)

The undersigned severally waive demand for payment, presentment for payment and notice of dishonor and the extension of the time of payment without notice. The construction, validity and effect of this note shall be governed by the laws of Illinois. The undersigned acknowledge receipt of a duplicate of this instrument before consummation of the loan.

WITNESS ______ (Borrower)

APPENDIX I (2)

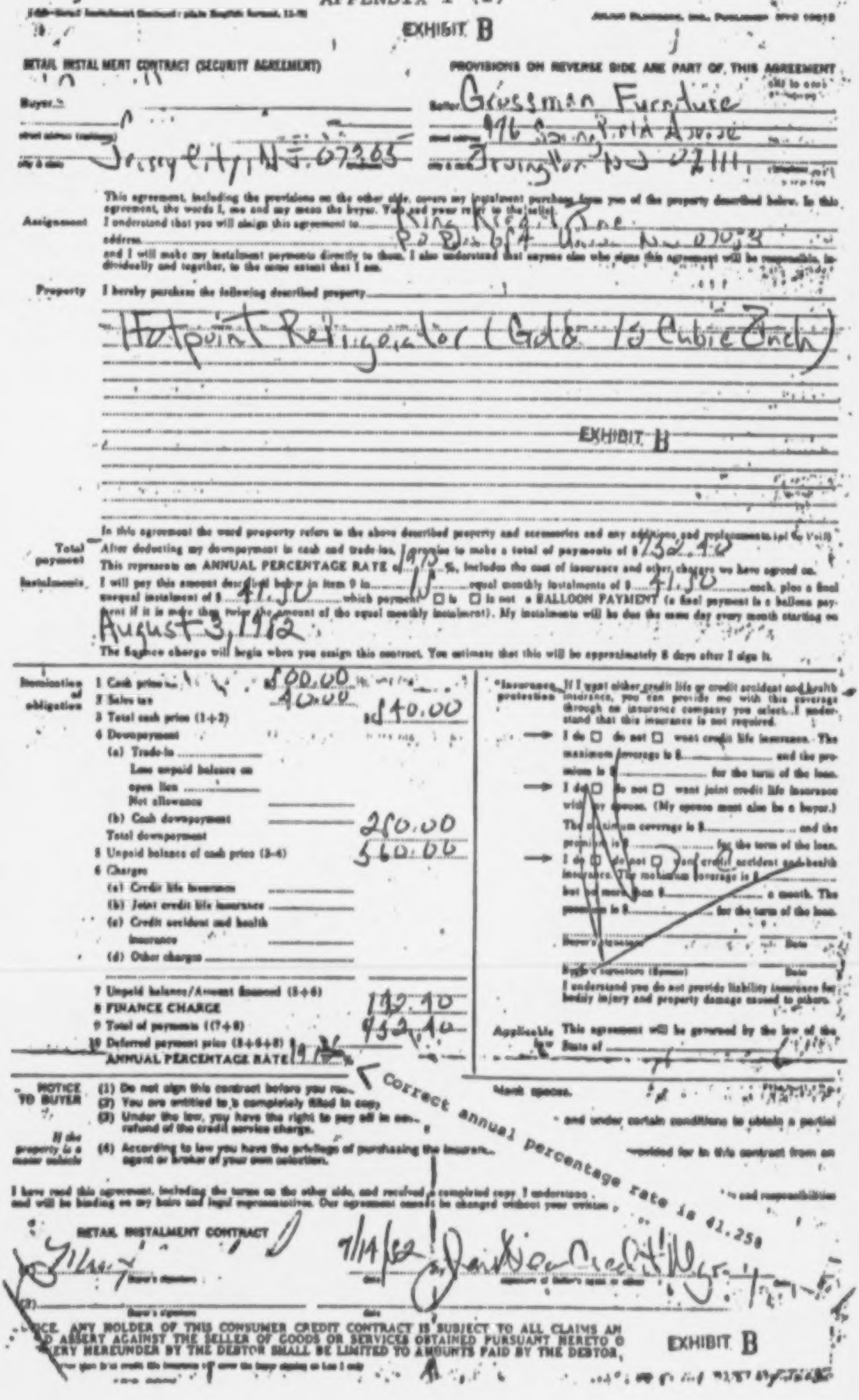


EXHIBIT B

RETAIL INSTALMENT CONTRACT (SECURITY AGREEMENT)

PROVISIONS ON REVERSE SIDE ARE PART OF THIS AGREEMENT

Buyer
street address
city & state Jersey City, N.J. 07305

Seller Grossman Furniture
street address 976 Springfield Avenue
city & state Irvington N.J. 07111

This agreement, including the provisions on the other side, covers my instalment purchase from you of the property described below. In this agreement, the words I, me and my mean the buyer. You and your refer to the seller.

Assignment I understand that you will assign this agreement to King Credit Line
address P.O. Box 654 Union N.J. 07083
and I will make my instalment payments directly to them. I also understand that anyone else who signs this agreement will be responsible, individually and together, to the same extent that I am.

Property I hereby purchase the following described property
Hotpoint Refrigerator (Gold 15 Cubic Inch)

EXHIBIT B

In this agreement the word property refers to the above described property and accessories and any additions and replacements.

Total payment After deducting my downpayment in cash and trade-ins, I promise to make a total of payments of $752.40
This represents an ANNUAL PERCENTAGE RATE of 19.75 %. Includes the cost of insurance and other charges we have agreed on.

Instalments I will pay this amount described below in item 9 in 15 equal monthly instalments of $ 41.50 each, plus a final unequal instalment of $ 41.50 which payment ☐ is ☐ is not a BALLOON PAYMENT (a final payment is a balloon payment if it is more than twice the amount of the equal monthly instalment). My instalments will be due the same day every month starting on August 3, 1982

The finance charge will begin when you assign this contract. You estimate that this will be approximately 8 days after I sign it.

Itemization of obligation

1 Cash price $500.00
2 Sales tax 40.00
3 Total cash price (1+2) $540.00
4 Downpayment
(a) Trade-in
Less unpaid balance on open lien
Net allowance
(b) Cash downpayment
Total downpayment 250.00
5 Unpaid balance of cash price (3-4) 560.00
6 Charges
(a) Credit life insurance
(b) Joint credit life insurance
(c) Credit accident and health insurance
(d) Other charges
7 Unpaid balance/Amount financed (5+6) 192.40
8 FINANCE CHARGE
9 Total of payments (7+8) 752.40
10 Deferred payment price (3+6+8)
ANNUAL PERCENTAGE RATE 19.75 %

< Correct annual percentage rate is 41.25%

***Insurance protection** If I want either credit life or credit accident and health insurance, you can provide me with this coverage through an insurance company you select. I understand that this insurance is not required.

→ I do ☐ do not ☐ want credit life insurance. The maximum coverage is $ and the premium is $ for the term of the loan.

→ I do ☐ do not ☐ want joint credit life insurance with my spouse. (My spouse must also be a buyer.) The maximum coverage is $ and the premium is $ for the term of the loan.

→ I do ☐ do not ☐ want credit accident and health insurance. The maximum coverage is $ but not more than $ a month. The premium is $ for the term of the loan.

Buyer's signature Date

Buyer's signature (Spouse) Date

I understand you do not provide liability insurance for bodily injury and property damage caused to others.

Applicable law This agreement will be governed by the law of the State of

blank spaces.

NOTICE TO BUYER

(1) Do not sign this contract before you re...
(2) You are entitled to a completely filled in copy
(3) Under the law, you have the right to pay off in ad... and under certain conditions to obtain a partial refund of the credit service charge.

If the property is a motor vehicle

(4) According to law you have the privilege of purchasing the insuran... provided for in this contract from an agent or broker of your own selection.

I have read this agreement, including the terms on the other side, and received a completed copy. I understand ... and responsibilities and will be binding on my heirs and legal representatives. Our agreement cannot be changed without your written ...

RETAIL INSTALMENT CONTRACT

(1) Buyer's signature 7/14/82 date Jackson Credit Mgr. signature of Seller's agent or officer

(2) Buyer's signature date

...ICE. ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AN... ...D ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO O... ...VERY HEREUNDER BY THE DEBTOR SHALL BE LIMITED TO AMOUNTS PAID BY THE DEBTOR.

EXHIBIT B

National Savings and Loan League

1101 15th Street NW
Washington, DC 20005
202 331-0270 Cable: NATLISA

Jim Cousins
Senior Vice President
For Governmental Affairs

April 12, 1983

Honorable Jake Garn, Chairman
Committee on Banking, Housing
and Urban Affairs
SD 534
United States Senate
Washington, D.C. 20510

Dear Chairman Garn:

On behalf of the officers and members of the National Savings and Loan League, I wish to convey to you and your colleagues the National League's support for S. 730 which is before your committee today. Inasmuch as the bill is virtually the same as that introduced last Congress and on which we testified in 1981, and inasmuch as the members of the National League reaffirmed their support on February 8 of this year, I respectfully request that the League's testimony of July 15, 1981 be made a part of today's record along with this letter.

Sincerely yours,

Jim Cousins

Jim Cousins

JC:mr

Testimony of
Frank L. Coffman, Jr.

Mr. Chairman, Members of the Subcommittee, I am Frank L. Coffman, President of First Federal Savings and Loan Association of Harrison, Arkansas. I am here today speaking on behalf of the National Savings and Loan League.

Mr. Chairman, last year the Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980 (PL 96-221), one of the most significant financial institutions bills to be signed into law in fifty years. The purpose of that legislation and many of its specific provisions bear directly on the issue before this Subcommittee today.

By enacting this legislation, Congress set in motion a six-year transition toward a more competitive, free market environment for the nation's financial institutions in which rates paid to savers by commercial banks and thrift institutions on all forms of savings will be set by the market rather than by regulators. The Congress had two objectives in mind--equity for savers and enhancement of the competitive position of banks and thrifts vis-a-vis nondepository competitors, such as money market mutual funds. The Congress recognized, however, that the nation's savings and loan associations are not able to compete directly with banks in a free market environment because thrift assets are restricted essentially to long-term, fixed-rate mortgage loans and because the range of services they can offer is limited.

To improve the competitive position of the savings and loan industry and permit it to increase earnings, PL 96-221 provides, among other things, NOW account authority, trust account powers, and a limited authority for consumer lending. The new law allows a federal savings and loan association to have up to 20% of its assets in consumer loans, secured or unsecured.

Profitable consumer lending will be critical to the future viability of many savings and loan associations. If, as the law mandates, we are going to pay depositors a market rate of return on their savings, we have to be able to earn a market rate of return on our assets. To do this, the asset portfolio has to be more market sensitive. This can best be accomplished by improving the mortgage instrument itself (a goal which the FHLBB has pursued vigorously and constructively) and by diversifying the institution's assets structure to include shorter maturity, high turnover loans so that the income to the association keeps pace with economic cycles and fluctuations in market interest rates. Obviously, consumer loans can contribute to this objective.

The Congress recognized that even under the best of conditions, thrift institutions can not accomplish this asset adjustment overnight, and provided accordingly a six-year transition leading to the end of Regulation Q. The consumer lending business is already highly competitive because banks, finance companies and credit unions compete for the same market. As a practical matter, it will be several years before savings and loan associations capture a significant share of this market. Of course, the more competitors there are in the market, the better from the consumer's point of view.

It should be obvious, Mr. Chairman, that the consumer lending aspect of PL 96-221 can only accomplish its stated objective if savings and loan institutions can profitably pursue this line of business. One of the primary obstacles to a profitable consumer lending program today is the existence of outdated, arbitrary, rigid usury laws in many states.

Economic Uncertainty

Several economists have advised the National League that we can expect inflation to continue at or near 10% per year for the foreseeable future and that, given Federal Reserve monetary control policies, interest rates will continue to be highly volatile. In this kind of economic environment, interest rate ceilings, which are not quickly or readily responsive, result in distortions of the credit market. Credit availability is restricted where the anticipated return is below generally prevailing rates.

Consumer interests and the overall efficiency of our economy will be better served by a system that allocates credit by price and competition.

The demand and need for credit in the context of economic uncertainty justifies the preemptive actions taken by Congress in PL 96-221 and also justifies extending the general preemption of mortgage lending usury ceilings to consumer lending.

Moreover, when national market interest rates fluctuate as greatly as they have this past year, fixed usury ceilings distort the allocation of credit and inhibit the overall efficiency of our economy's delivery of goods and services. Where usury ceilings are substantially below market rates, credit is restricted.

Market interest rates in every state are virtually dictated by policy decisions made here in Washington. Every savings and loan association in the country is subject to the fiscal and monetary policy actions of the Congress, the Treasury and the Federal Reserve. Actions of these federal authorities have resulted in a situation where the rates we must pay to attract savings is higher than the return on existing loan portfolios and, in many cases, higher than loan rates permitted by state law. We feel justified, therefore, in urging the federal government to give us relief from usury restrictions since federal government policy is the key determinant of our cost of funds.

Due to market conditions, an ever-increasing dependence on short-term, market-sensitive deposits, and recent actions of the DIDC, the deregulation of our liability structure is proceeding much faster than anyone expected on March 31, 1980. The elimination of interest rate controls has increased the cost of funds to financial institutions. Costs incurred by these institutions are essentially a function of national economic events and policies. States neither determine these policies nor can they protect institutions from their effects. It is inequitable to both lenders and borrowers for the cost of funds to be determined on a national level while decisions regarding interest rate ceilings on credit extensions are left to state governments. The costs and price of funds are directly related, and the federal government should recognize this relationship.

Many members of this subcommittee will recall that we made these same arguments in this hearing room with respect to mortgage credit in 1979 and 1980. We firmly believe that the case for federal preemption is equally justified for consumer loans.

Interagency Task Force on Thrift Institutions

One of the provisions of PL 96-221 was the creation of an interagency task force set up for the purpose of looking ahead to the future of the thrift institutions of this country and making a report of its findings and recommendations to the Congress. The Report of the Task Force, filed on June 30, 1980, contains an analysis of state usury laws governing consumer lending. The findings of the Task Force are essentially consistent with the view we have expressed here today. We were greatly encouraged by their recommendation that Congress seriously consider a general preemption in the area of consumer credit.

As to the importance of this issue to the thrift industry, the Task Force said:

> "And any improvement in the functioning of the consumer lending market could enhance the ability of thrifts to participate directly in this area. This could improve thrifts' ability to compete with other financial intermediaries for consumer deposits as well as improve thrifts' earnings through their participation in the consumer credit area."

The Task Force also concluded that:

> "Thrifts may have little incentive to diversify into consumer lending as long as state restrictions on finance rates make such lending unprofitable. The problems generally caused by usury limits are not new but have been more evident recently as market interest rates rose above these ceilings. As the cost of funds rises but usury ceilings restrict the permissible finance rate that may be charged, lending institutions channel funds into other types of loans or other geographic markets."

Finally, as to the impact on credit availability and consumer protection, the Report says:

> "Permitting thrift institutions to offer a wide variety of credit potentially increases the options available to borrowers. This in itself should reduce the need for usury ceilings as a protection for consumers against monopolistic lending practices. At the same time, consumer lending undertaken by thrifts could provide increased cash flow and, after start-up costs are covered, more flexible earnings for thrifts, thus strengthening their long-run ability to provide mortgage-origination services and to attract deposits as a source of funds as well."

S. 1406 and S. 963

The National League welcomed the introduction of the two bills before the subcommittee today. We are grateful to Senators Bumpers and Pryor for introducing S. 963 and Senators Lugar, Garn, D'Amato and Proxmire for sponsoring S. 1406.

S. 963 would permit any lender to lend at a rate of up to 1% above the Fed discount rate (inclusive of surcharges). I am advised that currently this approach would permit loan rates of up to about 19% in states with usury ceilings below that rate. While this legislation would certainly help my institutions and other lenders in Arkansas (where we currently have a 10% usury ceiling), it is the opinion of the National League that S. 963 is not the most desirable approach. There are two reasons for this. First, the arguments we have made are equally applicable to usury ceilings whether they be state or federal in origin. Second, while there is an historic virtue to the discount rate index it is, given today's economic environment, a very unsatisfactory index. The discount rate is a regulatory tool of the Federal Reserve, and, as such, cannot be relied on to reflect market swings affecting our institutions' cost of funds.

The National League's preference is for a total, broad preemption such as would be provided by S. 1406. This bill would extend the mortgage preemption approach of PL 96-221 to the consumer and business and agriculture loan field with the opportunity for each state to reimpose a usury standard if it so desires. Not only does S. 1406 protect the right of states to reimpose usury limits, it explicitly recognizes the role of state law in providing consumer protection with respect to credit transactions. The bill preempts state law only with respect to restitutions on the terms and conditions of consumer credit programs of depository institutions. In this area, competition is the consumer's best protection.

Conclusion

Mr. Chairman, the National League appreciates this opportunity to state its views on this issue, to endorse S. 1406 and to urge speedy enactment by Congress. I look forward to your questions.

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JOHN P. McALLISTER
JOHN W. HAZARD, JR.*
*NOT ADMITTED IN D. C.

April 5, 1983

Honorable Jake Garn, Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
5300 Dirksen Senate Office Building
Washington, D.C. 20510

Re: S.730

Dear Senator Garn:

We represent the National Home Furnishings Association (NHFA) which is the national trade association whose members operate approximately 12,000 home furnishing retail stores throughout the United States. NHFA wishes to express its support for S.730, which we understand will be the subject of hearings later this month. Members of NHFA extend credit to consumers throughout the United States who are purchasing furniture or other home furnishings. As a representative of such consumer credit grantors, we have testified before Congress in the past in support of similar legislation and would like to be on record as supporting S.730.

Yours very truly,

WEBSTER, CHAMBERLAIN & BEAN

By
Arthur L. Herold
Counsel to the National Home
Furnishings Association

ALH/bkd

THE PRICE AND AVAILABILITY OF CONSUMER CREDIT IN NEW YORK STATE

by

Ernest Kohn
Carmen J. Carlo
Bernard Kaye

New York State Banking Department
December 1982

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I. INTRODUCTION

In November 1980, the New York State Legislature passed, and the Governor signed into law, the Omnibus Banking Bill. One of its key provisions was the elimination of virtually all interest rate ceilings, except criminal usury, on consumer loans in New York State. However, this deregulation of consumer credit interest rates expires June 30, 1983. Unless the State Legislature acts by that date, the interest rate ceilings that had existed prior to passage of this bill will go back into effect.

In order to provide information to the Legislature on the current and past status of interest rates, charges and fees on consumer loans as well as the availability of consumer credit, the Banking Department undertook a survey of financial institutions and others who extend credit to consumers in New York State.

This is the second such survey by the Banking Department. The first survey was conducted in January-February 1981 to develop information on the initial experience with deregulation under the Omnibus Banking Bill. The major findings of that first survey were that interest rates on consumer credit had risen after passage of the bill since the previous rate ceilings had been unrealistically low; that there was an increase in the availability of consumer credit for New Yorkers; and that banks were offering a wide range of rates and fees, thereby providing consumers with alternative choices which they could take advantage of by shopping for credit.

The second survey was conducted in September 1982 when questionnaires were sent to both State and federally chartered financial institutions in New York State, including commercial banks, savings banks, savings and loan associations, credit unions and licensed lenders. In addition, questionnaires were sent to a sample of retail stores and automobile dealers throughout the State. Responses were received from more than 72% of the financial institutions but from a much lower proportion of retailers and car dealers (Table 1). Among the banking institutions, a higher rate of response was received from those under State charter than those under federal charter.

The questionnaires sought information on the "most common" interest rate or finance charge to borrowers for various types of consumer loans. The "most common" rate or charge was defined as that charged on the largest dollar volume of new loans made in that particular category on the dates indicated on the questionnaire form. In the case of credit cards and other types of revolving credit, data on annual fees or other charges were also requested. In addition, the institutions and firms surveyed were asked to indicate whether the rates, charges and fees were the same at all their offices or places of business in New York State; whether they were the same for all borrowers regardless of whether the applicant had an established relationship with the institution or firm; and whether, since February 1981, there had been any further liberalization of credit standards, increased participation in consumer lending or larger credit lines made available on consumer loans.

Information on rates, charges and fees was sought for three dates: January 2, 1981, which was the final date utilized in the Department's first questionnaire survey, January 2, 1982 and September 15, 1982. The respondents were also asked to list the effective dates of any changes in these rates, charges or fees since January 2, 1981.

In order to update the findings, a telephone survey was made during November 1982 of a sample of financial institutions, retail stores and car dealers.

TABLE 1

NUMBER OF QUESTIONNAIRES SENT OUT AND RESPONSES RECEIVED

	Number of	
	Questionnaires Sent Out	Responses Received
Commercial Banks	222	160
Savings Banks	98	92
Savings & Loan Associations	95	65
Credit Unions	105	54
Licensed Lenders	38	31
Retail Stores	80	15
Automobile Dealers	260	58
Total	898	475

II. SUMMARY OF MAJOR FINDINGS

The major findings of the Banking Department's survey are the following:

First, because the Omnibus Banking Bill granted additional consumer lending powers to savings banks and savings and loan associations, the number of banking institutions offering consumer loans has increased substantially (Chart 1). Many thrift institutions are now offering automobile loans on both new and used cars, second mortgage loans and unsecured personal instalment loans. As a result, there is a greater degree of competition in consumer lending and a wider range of choice for consumers among different types of banking institutions.

While the aggregate dollar amount of consumer loans made by thrift institutions is still small relative to the consumer lending activity of commercial banks, they are making inroads into this type of lending and can be expected to increase their market share in the future. Competition and consumer choice can therefore be expected to be further enhanced as time goes on.

Second, the survey revealed that there are wide variations in rates charged by different institutions in the same market area for the same type of loan, thereby providing consumers with alternative choices which they can take advantage of by shopping for credit. This is best illustrated by the results of the telephone survey made in early November 1982 of a sample of large commercial banks in New York City and upstate (Chart 2).

In New York City, for example, the current rate structure on consumer loans indicates that:

- On conventional home improvement loans, different banks are charging rates ranging from 16.5% to 19% for depositors, and 18% to 21% for others.
- On new car loans, the available rates range from 14.5% to 18% for depositors, and from 14.5% to 20% for non-depositors; on used car loans, from 16.5% to 19% for depositors, and 17.25% to 21% for non-depositors.
- On second mortgage loans, the rates range from 14.5% to 17.7% for depositors, and 14.5% to 19% for non-depositors.
- On overdraft checking loans, the rates range from 18% to 19.8%; on other unsecured personal loans, from 17.5% to 19% for depositors, and 19% to 21% for non-depositors.
- On credit cards, rates range from 18% to 19.8%, with annual fees ranging from zero to $20 for depositors, and $12 to $20 for non-depositors.

Substantial variation in rates is also evident in each of the major upstate metropolitan areas. Since a number of New York City banks as well as some of the large upstate banks have branches in various upstate communities, their rates and charges are available in many different parts of the State. As a result, there is a broad range of choices available to the public among banks in every major metropolitan area in upstate New York. For example, in the Albany area, the following range of rates is available from banks with offices there:

- On home improvement loans, rates range from 15% to 19% for depositors, and from 15% to 19.75% for non-depositors.
- On new car loans, rates range from 14.5% to 18% for depositors and non-depositors; on used car loans, from 15% to 19% for depositors, and from 15% to 20.5% for non-depositors.
- On second mortgage loans, the rates range from 15.5% to 17% for depositors, and from 16% to 17.5% for non-depositors.
- On overdraft checking loans, the rates range from 18% to 20%; on other unsecured personal loans, from 16% to 19% for depositors, and from 16% to 20.5% for non-depositors.

- On credit cards, rates range from 18% to 19.8% with annual fees ranging from $12 to $20.

Similar patterns of variation in rates are evident among banks in the Utica, Syracuse, Rochester and Buffalo metropolitan areas.

The figures cited actually understate the degree of variation in rates available to the public since they do not include all of the banks with offices in these areas. Moreover, since commercial banks make the bulk of the consumer loans, the telephone survey was limited to those banks and therefore does not include the rates available at thrift institutions as well as at other lenders located in these areas.

Variation in rates is also evident among other types of lenders in the consumer credit field, including thrift institutions, licensed lenders, automobile dealers and retail stores.

Third, as market interest rates have fluctuated there have been changes in rates charged on consumer loans. Rates generally increased for most types of consumer loans during 1981 reflecting the high level of market interest rates throughout most of the year. However, as market rates eased off and then fell sharply during the second half of 1982, many commercial banks, including most of the large banks in New York City and upstate, cut their consumer loan rates during 1982 by an average of up to about 1-1/2% (Charts 3, 4 and 5). This was particularly evident for automobile loans on both new and used cars, home improvement loans, second mortgage loans and unsecured personal loans, although about a dozen banks increased their rates or fees on credit cards during 1982. In addition, many thrift institutions lowered their rates during 1982 on automobile loans, home improvement loans, second mortgage loans and unsecured personal loans. Some car dealers also cut their rates on new and used car loans during 1982.

Fourth, the more liberal credit standards for consumer lending, the larger credit lines and the greater participation in consumer loan activity by banks which occurred in early 1981, shortly after passage of the Omnibus Banking Bill, has continued since then and further liberalization of, and participation in, consumer lending later in 1981 and in 1982 was reported by a significant number of banks (Charts 6 and 7).

The detailed findings of the survey are set forth in Section III.

CHART 1

INCREASE IN NUMBER OF FINANCIAL INSTITUTIONS
OFFERING VARIOUS TYPES OF LOANS
SINCE PASSAGE OF OMNIBUS BANKING BILL

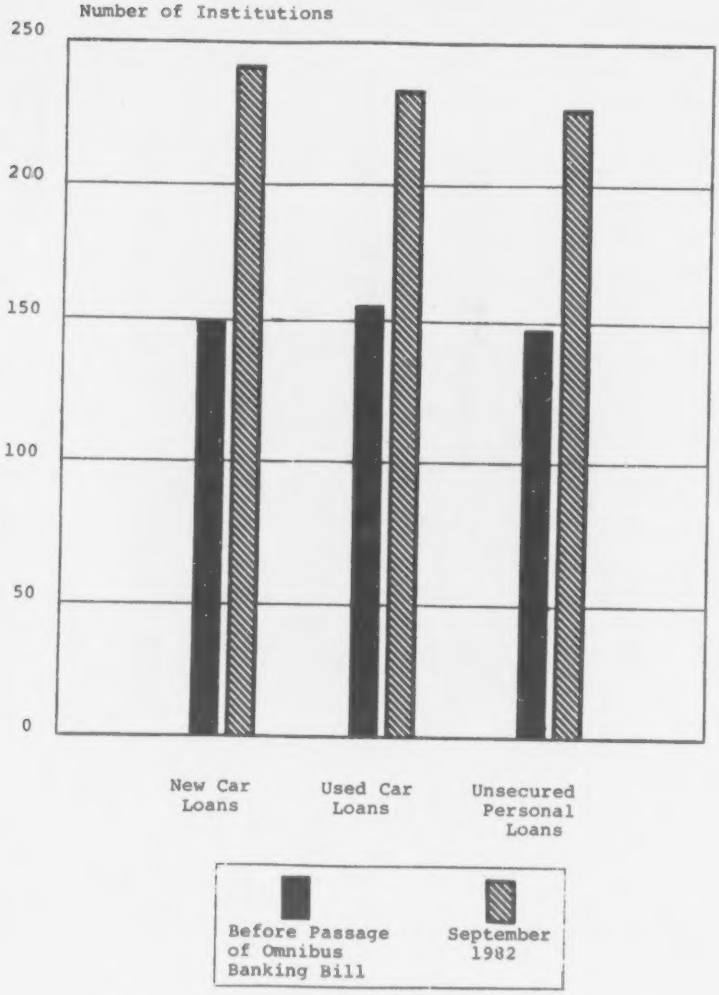


CHART 2

RANGE OF RATES ON VARIOUS TYPES OF CONSUMER LOANS
OFFERED BY COMMERCIAL BANKS IN NEW YORK CITY AND ALBANY AREAS
NOVEMBER 1982

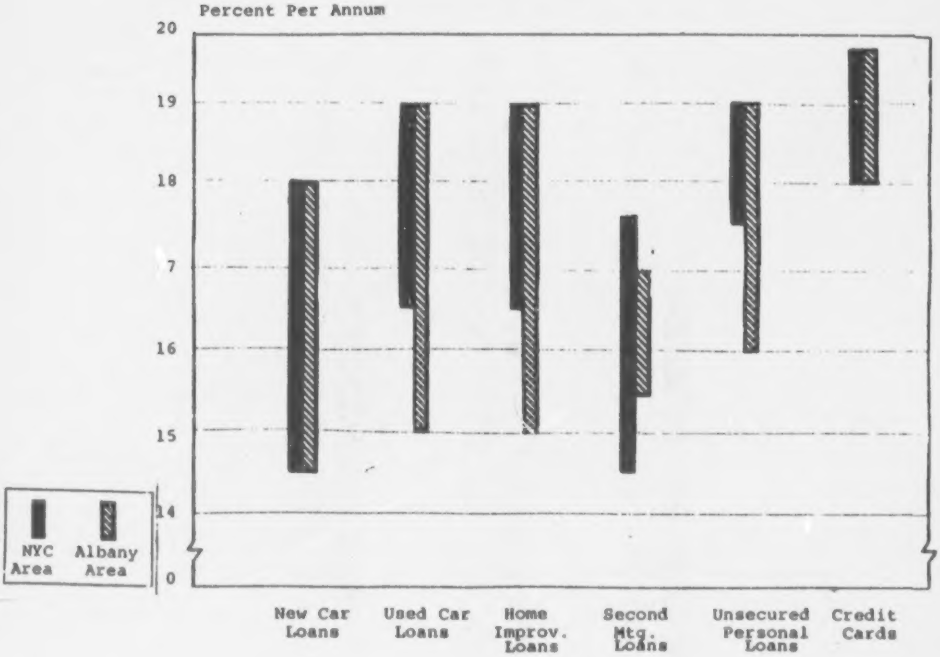


CHART 3

NUMBER OF FINANCIAL INSTITUTIONS WHICH REDUCED RATES ON VARIOUS TYPES OF CONSUMER LOANS DURING 1982

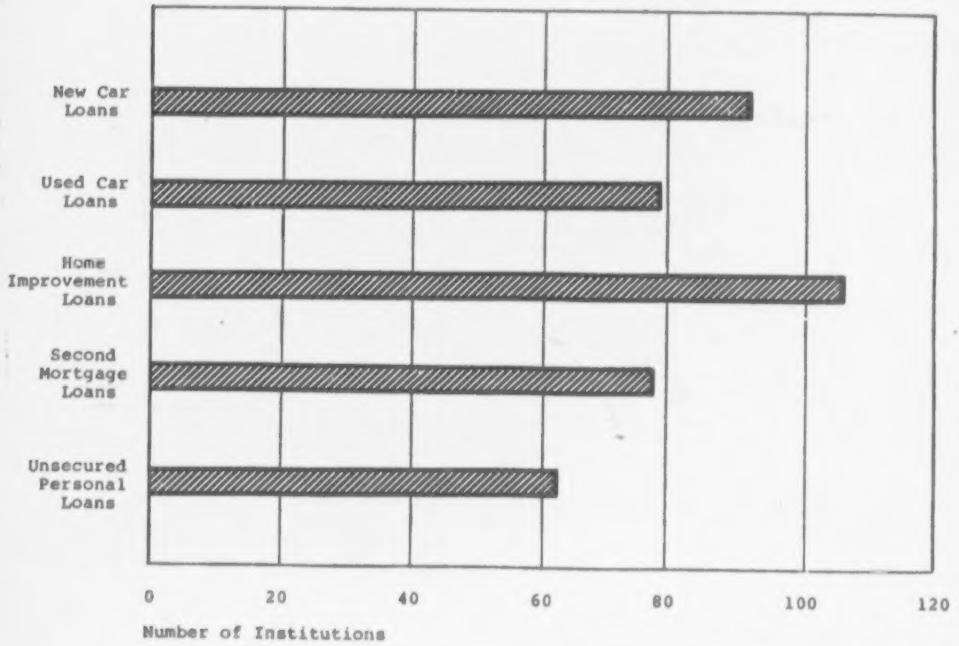


CHART 4

PERCENTAGE OF FINANCIAL INSTITUTIONS WHICH REDUCED RATES ON VARIOUS TYPES OF CONSUMER LOANS DURING 1982

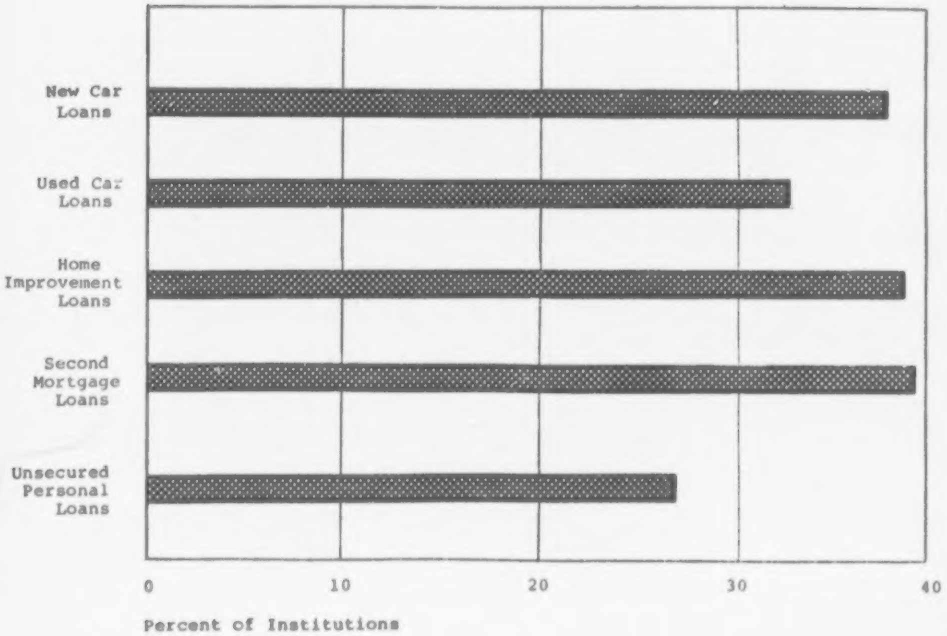


CHART 5
AVERAGE RATE REDUCTION BY FINANCIAL INSTITUTIONS
ON VARIOUS TYPES OF CONSUMER LOANS DURING 1982

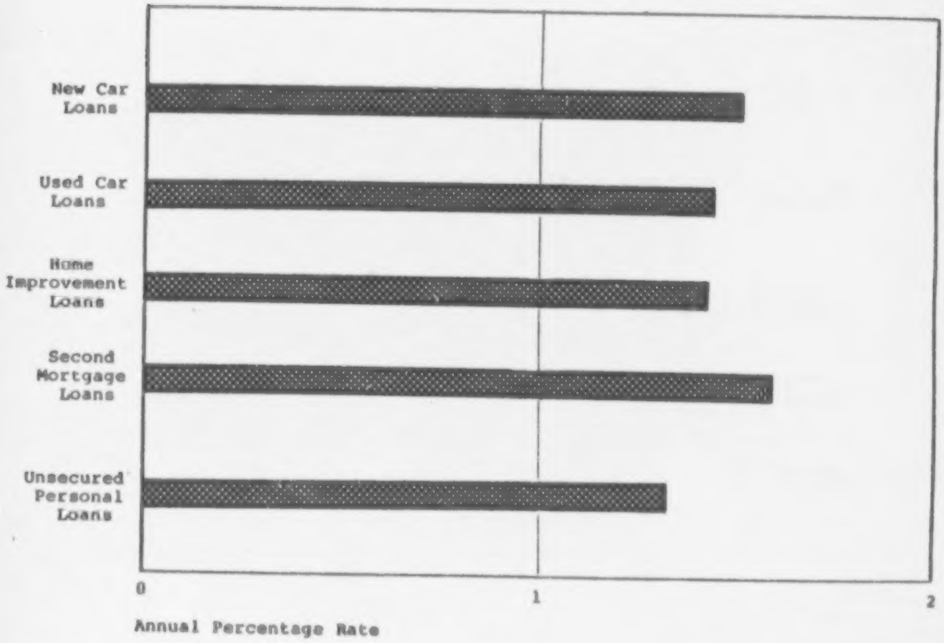


CHART 6

NUMBER OF FINANCIAL INSTITUTIONS

WHICH FURTHER LIBERALIZED CONSUMER CREDIT

SINCE FEBRUARY 1981

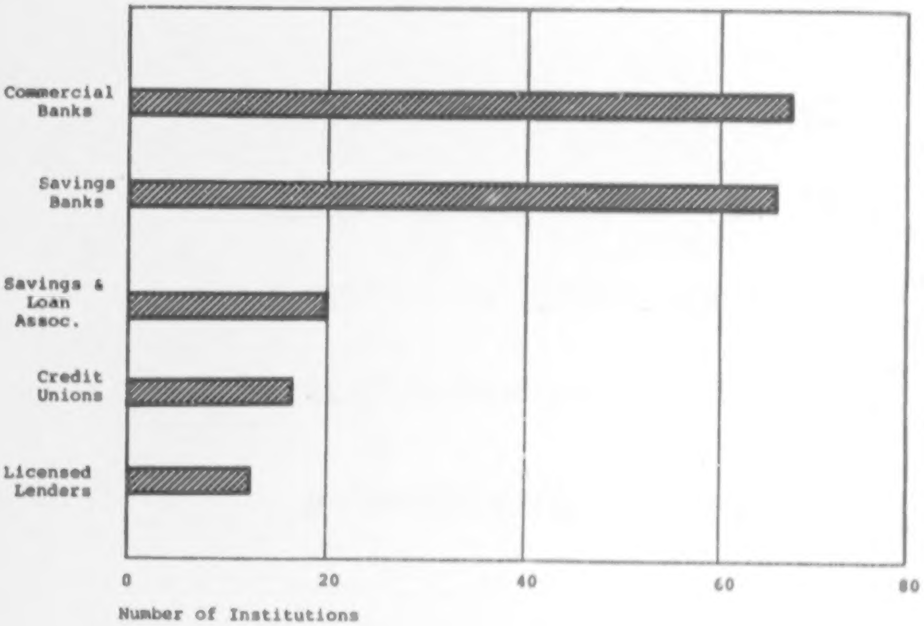
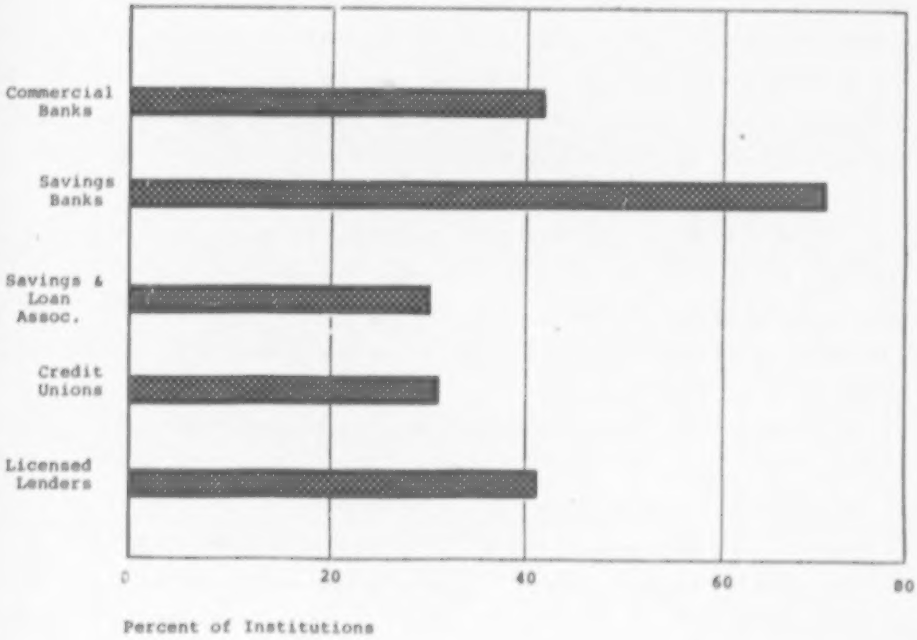


CHART 7
PERCENTAGE OF FINANCIAL INSTITUTIONS WHICH FURTHER LIBERALIZED
CONSUMER CREDIT SINCE FEBRUARY 1981



III. DETAILED RESULTS OF THE SURVEY

A. Commercial Banks

Responses were received from 160 commercial banks, of which 130 were headquartered outside New York City and 30 were headquartered in the City. Some banks did not report interest rates on all types of loans specified in the questionnaire because they did not offer such loans. This was particularly true for education loans, second mortgage loans and the issuance of credit cards.

Generally, the survey indicated that the average interest rates at New York City banks trended upward for most types of consumer loans between January 2, 1981 and September 15, 1982. Outside the City, average interest rates for some types of loans increased during 1981 and then declined somewhat during 1982 while for other types of credit (such as credit cards, overdraft checking and loans secured by savings accounts), average rates moved upward both during 1981 and 1982 (Tables 2 to 5).* Throughout the period covered by the survey, New York City bank rates usually averaged higher than those upstate.

However, the sample telephone survey in November 1982 indicated reductions in rates for many types of consumer loans since September 15, 1982 at almost all of the large New York City and upstate banks contacted. For example, eight of the nine large New York City banks surveyed by telephone reported reductions in interest rates on various types of loans since September 15, 1982 while two banks reported an increase in their annual fees on credit cards. The cuts in loan rates applied most frequently to home improvement loans, new and used car loans, second mortgage loans, loans secured by savings accounts and unsecured personal loans (Table 6).

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* The tabulations in this study are based on the rates charged to customers who had deposit or loan relationships with the bank, which almost invariably were the most common rates on loans made. The tabulations as of November 1982 for the sample of banks contacted by phone also include, in parentheses, the rates for those borrowers who had no other relationships with the bank. This procedure was utilized throughout this report.

Outside New York City, 13 out of 14 banks contacted by telephone indicated that they had cut loan rates since September 15, 1982, mainly on home improvement loans, new and used car loans, second mortgage loans, loans secured by savings accounts and unsecured personal loans (Table 7). Two banks reported an increase in loan rates since September 15, one for overdraft checking loans and the other for used car loans.

There were wide variations in rates charged by banks both in New York City and upstate. This was evident from the ranges in rates cited in Tables 2 to 5 for the various dates specified in the questionnaire. It is further highlighted by the sample telephone survey in November 1982, which is summarized in Tables 8 to 13. These tabulations indicate that there is a wide range of rates available to the public among banks in every major metropolitan area in the state, including the New York City, Albany, Utica, Syracuse, Rochester and Buffalo areas -- underscoring the importance of consumers shopping for the best credit deal available.

In terms of offering new consumer loan services, the major change was that by September 1982, 64 banks were offering loans guaranteed by the New York State Higher Education Services Corporation to parents of students, which were first instituted in October of 1981. A total of 111 banks were making guaranteed loans to students.**

The most substantial increases in rates and fees occurred for credit cards. Statewide, on balances over $500 for purchases, the average rate increased from 12.7% in January 1981 to 18.5% in September 1982. On cash advances, the average rate rose from 12.3% to 18.4%. The number of banks statewide charging an annual fee on credit cards increased from one in January 1981 to 42 by September 1982. These increases generally presented the delayed response to the deregulation of rates by the Omnibus Banking Bill. In January 1981, most banks had not had sufficient time to change rates or institute fees on credit cards due to the 30-day advance notice requirements of that law.

Although market interest rates declined during 1982, lowering the cost of funds to banks, rates and fees on credit cards have not been reduced, and in fact have been increased at some banks during 1982. Among the factors cited by various banks as the reasons for this are the continuing increases in labor and other costs due to inflation; increased losses due to fraud; the unprofitability of credit card operations during 1981 when the cost of funds was high so that the subsequent decline in the cost of funds only reduced these losses or enabled credit card operations to become marginally profitable in 1982;

** The New York State Higher Education Services Corporation reduced the maximum rate which can be charged on guaranteed educational loans to parents of students from 14% to 12% effective November 1, 1982. All banks making these loans as well as loans to students, for which the maximum was 9%, did so at the maximum rate.

and since operating and handling costs (excluding cost of funds) are a much larger percentage of outstanding balances for credit card operations than they are for other types of consumer loans, they would tend to be less responsive to declines in cost of funds than other types of consumer loans. Sufficient data are not available to enable an independent evaluation to be made of the significance of these factors.

Almost all banks indicated that they charged the same rates at all offices and almost two-thirds of the respondents stated that their rates were the same for all customers. Among New York City banks, however, slightly over half reported that they charged different rates for different customers. Generally, persons who had no other deposit or loan accounts with the bank were charged a higher rate on their consumer loans than those who did have such accounts.

With respect to credit availability, the more liberal credit standards for consumer lending, the larger credit lines and the greater participation in consumer loan activity by banks which occurred by early 1981, shortly after passage of the Omnibus Banking Bill, have continued since then. Moreover, a substantial minority (38%) of the respondents statewide indicated that they had increased their participation in consumer lending since February 1981; 17% of the respondents (including 43% of the New York City banks) raised their maximum lines of credit since that date; and 7% of the respondents (including 24% of the New York City banks) liberalized their consumer loan standards.

TABLE 2

ANNUAL PERCENTAGE RATES
ON HOME IMPROVEMENT LOANS AND CAR LOANS
COMMERCIAL BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
	Conventional Home Improvement Loans					
Average Rate	17.91 %	18.50 %	18.49 %	17.03 %	17.87 %	17.72 %
Range of Rates	12.70-21.00	17.00-20.00	14.50-21.00	9.00-20.00	15.00-20.00	15.00-20.00
	New Car Loans					
Average Rate	17.59	17.80	17.94	16.57	17.18	16.90
Range of Rates	12.08-20.00	15.50-20.00	15.50-20.00	9.00-20.39	12.50-20.00	12.50-20.00
	Loans On Used Cars Under 2 Years Old					
Average Rate	17.92	18.34	18.49	17.18	17.86	17.74
Range of Rates	13.38-21.00	17.00-20.00	16.75-20.00	9.00-21.08	13.50-20.00	14.54-20.00
	Loans On Used Cars Over 2 Years Old					
Average Rate	18.02	18.63	18.71	17.29	18.05	17.91
Range of Rates	13.38-21.00	17.00-20.00	16.75-21.00	9.00-21.08	13.50-21.75	13.50-20.00

TABLE 3

ANNUAL PERCENTAGE RATES AND FEES ON CREDIT CARDS COMMERCIAL BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
For Purchases - Balances Up to $500						
Average Rate	18.15 %	18.30 %	18.88 %	17.44 %	18.15 %	18.64 %
Range of Rates	18.00-19.80	18.00-19.80	18.00-19.80	12.00-18.00	17.50-19.92	18.00-19.92
For Purchases - Balances Over $500						
Average Rate	12.65	18.30	18.88	12.75	17.85	18.34
Range of Rates	12.00-19.80	18.00-19.80	18.00-19.80	12.00-18.00	12.00-19.92	12.00-19.92
For Cash Advances						
Average Rate	12.60	18.27	18.81	12.15	17.86	18.32
Range of Rates	12.00-19.80	18.00-19.80	18.00-19.80	12.00-15.00	12.00-19.92	12.00-19.92
Annual Fees						
Average Fee	$15.00*	$14.50	$15.20	-	$14.21	$14.45
Range of Fees	15.00-15.00	10.00-15.00	10.00-20.00	-	10.00-15.00	10.00-15.00

* Only one respondent in New York City charged a fee on January 2, 1981, while none did outside the City.

TABLE 4

ANNUAL PERCENTAGE RATES
ON EDUCATION LOANS
COMMERCIAL BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
	Loans to Students Guaranteed by NYSHESC					
Average Rate	9.00 %	9.00%	9.00 %	9.00 %	9.00 %	9.00 %
Range of Rates	9.00- 9.00	9.00- 9.00	9.00- 9.00	9.00- 9.00	9.00- 9.00	9.00- 9.00
	Loans to Parents Guaranteed by NYSHESC					
Average Rate	-	14.00	14.00	-	14.00	14.00
Range of Rates	-	14.00- 14.00	14.00- 14.00	-	14.00- 14.00	14.00- 14.00

TABLE 5

ANNUAL PERCENTAGE RATES ON OTHER TYPES OF CONSUMER LOANS COMMERCIAL BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Second Mortgage Loans						
Average Rate	13.63 %	18.18 %	17.78 %	14.94 %	17.34 %	17.27 %
Range of Rates	12.00- 15.25	16.50- 19.00	15.50- 19.20	12.00- 16.00	15.00- 19.50	14.00- 20.00
Loans Secured by Regular or DOD/DOW Accounts						
Average Rate	16.40	16.82	17.06	13.64	14.45	14.49
Range of Rates	8.25- 20.00	8.25- 20.00	10.27- 20.00	6.25- 19.60	6.25- 20.00	6.25- 20.00
Overdraft Checking Loans						
Average Rate	13.00	17.87	18.34	12.74	17.51	17.77
Range of Rates	12.00- 18.00	12.00- 21.00	12.00- 21.00	12.00- 20.00	12.00- 20.00	12.00- 20.00
Unsecured Personal Loans						
Average Rate	18.21	18.77	18.85	17.28	18.14	18.04
Range of Rates	13.38- 20.00	17.00- 20.00	16.75- 21.00	9.00- 21.08	14.54- 21.00	14.54- 21.00

TABLE 6

CHANGES IN RATES AND FEES CHARGED ON CONSUMER LOANS BY COMMERCIAL BANKS IN NEW YORK CITY SINCE SEPTEMBER 15, 1982

	Rates and Fees Charged	
	Sept. 15, 1982	November 1982
Bank of New York		
New Car Loans	17.50%(19.00%)	14.50%(14.50%)
Second Mortgage Loans	17.50 (19.00)	15.50 (17.00)
Annual Fee on Credit Cards	None*	12.00*
Chase Manhattan Bank, N.A.		
Home Improvement Loans	19.75	18.25
New Car Loans	19.25	17.75
Used (under 2 yrs.) Car Loans	18.75	17.25
Used (over 2 yrs.) Car Loans	19.75	18.25
Second Mortgage Loans	17.00	14.50
Loans Secured by Savings Accts.	19.75	19.00
Unsecured Personal Loans	19.75	19.00
Chemical Bank		
Home Improvement Loans	19.00 (20.00)	17.50 (18.50)
New Car Loans	18.50 (19.50)	17.00 (18.00)
Used (under 2 yrs.) Car Loans	18.50 (19.50)	17.00 (18.00)
Used (over 2 yrs.) Car Loans	19.00 (20.00)	17.50 (18.50)
Second Mortgage Loans	18.50 (19.50)	16.50 (17.50)
Loans Secured by Savings Accts.	17.00	15.50
Unsecured Personal Loans	19.50 (20.50)	18.00 (19.00)
Annual Fee on Credit Cards	$15	$20**

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* As of September 15, there was no fee for previous card holders but a $12 fee for new card holders. The $12 fee will apply to all card holders effective January 1, 1983.

** Effective December 1, 1982.

TABLE 6 (continued)

CHANGES IN RATES AND FEES CHARGED ON CONSUMER LOANS BY COMMERCIAL BANKS IN NEW YORK CITY SINCE SEPTEMBER 15, 1982

	Rates and Fees Charged	
	Sept. 15, 1982	November 1982
Citibank, N.A.		
Home Improvement Loans	21.00%(23.00%)	19.00%(21.00%)
New Car Loans	20.00 (22.00)	18.00 (20.00)
Used (under 2 yrs.) Car Loans	20.00 (22.00)	18.00 (20.00)
Used (over 2 yrs.) Car Loans	21.00 (23.00)	19.00 (21.00)
Second Mortgage Loans	18.86 (20.86)	17.05 (19.05)
Loans Secured by Savings Accts.	20.00	18.00
Unsecured Personal Loans	21.00 (23.00)	19.00 (21.00)
European American Bank*		
Home Improvement Loans	17.50 (20.00)	16.50 (19.00)
New Car Loans	17.50 (20.00)	16.50 (19.00)
Used (under 2 yrs.) Car Loans	17.50 (20.00)	16.50 (19.00)
Used (over 2 yrs.) Car Loans	17.50 (20.00)	16.50 (19.00)
Overdraft Checking Loans	16.00	18.10
Annual Fee on Credit Cards	None (None)	None ($15)
Irving Trust Company		
No changes in rates.		
Manufacturers Hanover Trust Co.		
Home Improvement Loans	18.50 (19.50)	18.00 (18.00)
New Car Loans	18.00 (19.50)	17.00 (18.00)
Used (under 2 yrs.) Car Loans	18.00 (19.50)	16.50 (18.00)
Used (over 2 yrs.) Car Loans	18.00 (19.50)	16.50 (18.00)
Second Mortgage Loans	19.20 (19.50)	17.67 (18.18)
Loans Secured by Savings Accts.	18.00	16.50
Unsecured Personal Loans	19.50 (21.00)	18.00 (19.00)

* All rate changes effective December 1, 1982. The $15 fee on credit cards, effective October 1, 1982, applies only to non-depositors.

TABLE 6 (concluded)

CHANGES IN RATES AND FEES CHARGED ON CONSUMER LOANS BY COMMERCIAL BANKS IN NEW YORK CITY SINCE SEPTEMBER 15, 1982

	Rates and Fees Charged	
	Sept. 15, 1982	November 1982
National Bank of North America		
Home Improvement Loans	18.00%(20.00%)	17.00%(19.00%)
New Car Loans	18.00 (20.00)	17.00 (19.00)
Used (under 2 yrs.) Car Loans	18.00 (20.00)	17.00 (19.00)
Used (over 2 yrs.) Car Loans	18.00 (20.00)	17.00 (19.00)
Loans Secured by Savings Accts.	17.00	16.00
Unsecured Personal Loans	19.00 (20.00)	18.00 (19.00)
Republic National Bank		
Home Improvement Loans	19.00 (21.00)	18.50 (20.50)
New Car Loans	18.00 (20.00)	17.50 (19.50)
Used (under 2 yrs.) Car Loans	19.00 (21.00)	18.50 (20.50)
Used (over 2 yrs.) Car Loans	19.00 (21.00)	18.50 (20.50)
Loans Secured by Savings Accts.	17.00	16.00
Unsecured Personal Loans	19.00 (21.00)	18.50 (20.50)

NOTE: Some banks charge higher rates or fees to persons who have no deposit or other relationships with that bank. In the cases where this occurs, those higher rates or fees are indicated in parentheses.

TABLE 7

CHANGES IN RATES AND FEES CHARGED ON CONSUMER LOANS BY LARGE COMMERCIAL BANKS IN UPSTATE NEW YORK SINCE SEPTEMBER 15, 1982

	Rates and Fees Charged	
	Sept. 15, 1982	November 1982
Bankers Trust Co. of Albany, N.A.		
Home Improvement Loans	18.00 %	17.00 %
New Car Loans	17.00	16.00
Used (under 2 yrs.) Car Loans	18.00	17.00
Used (over 2 yrs.) Car Loans	18.00	17.00
Second Mortgage Loans	18.00	17.00
Loans Secured by Savings Accts.	16.50	16.00
Unsecured Personal Loans	18.00	17.00
Key Bank, N.A. (Albany)		
Home Improvement Loans	17.00	16.00
New Car Loans	17.00	16.00
Used (under 2 yrs.) Car Loans	17.00	16.00
Used (over 2 yrs.) Car Loans	17.00	16.00
Second Mortgage Loans	18.50	16.50
Loans Secured by Savings Accts.	17.00	16.00
Unsecured Personal Loans	17.00	16.00
State Bank of Albany		
Home Improvement Loans	18.00	15.00
New Car Loans	18.00	15.00
Used (under 2 yrs.) Car Loans	18.00	15.00
Used (over 2 yrs.) Car Loans	18.00	15.00
Second Mortgage Loans	18.00	16.00
Loans Secured by Savings Accts.	18.00	16.00
Unsecured Personal Loans	18.00	16.00
Oneida National Bank (Utica)		
Home Improvement Loans	17.50	17.00
New Car Loans	16.00	15.00
Used (under 2 yrs.) Car Loans	18.00	16.50
Used (over 2 yrs.) Car Loans	18.50	16.75
Second Mortgage Loans	18.50	17.75
Unsecured Personal Loans	18.50	17.75
Overdraft Checking	18.00	19.80

TABLE 7 (continued)

CHANGES IN RATES AND FEES CHARGED ON CONSUMER LOANS BY LARGE COMMERCIAL BANKS IN UPSTATE NEW YORK SINCE SEPTEMBER 15, 1982

	Rates and Fees Charged			
	Sept. 15, 1982		November 1982	
Key Bank of Central New York (Syracuse)				
Home Improvement Loans	16.50	%(17.00)	15.75	%(16.25)
New Car Loans	15.75	(16.25)	15.50	(16.00)
Second Mortgage Loans	16.50	(17.00)	16.00	(16.50)
Loans Secured by Savings Accts.	18.50		18.00	
Unsecured Personal Loans	18.50	(19.00)	18.00	(18.50)
Lincoln First Bank, N.A.-Central Division (Syracuse)				
Home Improvement Loans	15.25	(16.25)	14.40	(15.40)
New Car Loans	14.00	(15.00)	13.40	(14.40)
Used (under 2 yrs.) Car Loans	15.00	(16.00)	14.40	(15.40)
Used (over 2 yrs.) Car Loans	15.00	(16.00)	14.40	(15.40)
Unsecured Personal Loans	15.50	(16.50)	14.90	(15.90)
Merchants National Bank (Syracuse)				
Home Improvement Loans	18.00		17.00	
New Car Loans	17.00		15.50	
Used (under 2 yrs.) Car Loans	19.00		17.00	
Used (over 2 yrs.) Car Loans	19.00		17.00	
Overdraft Checking Loans	18.00		17.50	
Loans Secured by Savings Accts.	17.00		16.00	
Unsecured Personal Loans	18.00		17.00	
Central Trust Company (Rochester)				
Home Improvement Loans	18.50	(20.50)	18.00	(20.00)
New Car Loans	17.50	(19.50)	16.00	(18.00)
Unsecured Personal Loans	18.50	(20.50)	18.00	(20.00)
Used (under 2 yrs.) Car Loans	17.50	(19.50)	18.00	(20.00)
Used (over 2 yrs.) Car Loans	17.50	(19.50)	18.00	(20.00)

TABLE 7 (continued)

CHANGES IN RATES AND FEES CHARGED ON CONSUMER LOANS BY LARGE COMMERCIAL BANKS IN UPSTATE NEW YORK SINCE SEPTEMBER 15, 1982

	Rates and Fees Charged			
	Sept. 15, 1982		November 1982	
Lincoln First Bank, N.A. (Rochester)				
Home Improvement Loans	19.50	%(20.50)	18.00	%(19.00)
New Car Loans	18.00	(19.00)	16.50	(17.50)
Used (under 2 yrs.) Car Loans	19.00	(20.00)	17.50	(18.50)
Used (over 2 yrs.) Car Loans	19.00	(20.00)	17.50	(18.50)
Loans Secured by Savings Accts.	18.00		16.50	
Unsecured Personal Loans	19.50	(20.50)	16.50	(17.50)
Manufacturers Hanover, N.A. (Rochester)				
Home Improvement Loans	18.00		17.50	
New Car Loans	17.00		15.50	
Used (under 2 yrs.) Car Loans	18.00		17.50	
Used (over 2 yrs.) Car Loans	18.00		17.50	
Loans Secured by Savings Accts.	18.00		17.50	
Unsecured Personal Loans	18.00		17.50	
Security Trust Company (Rochester)				
Home Improvement Loans	17.75	(18.25)	15.75	(16.25)
New Car Loans	16.75	(17.75)	14.75	(15.25)
Used (under 2 yrs.) Car Loans	18.75		16.75	(17.25)
Used (over 2 yrs.) Car Loans	19.75		17.75	(18.25)
Second Mortgage Loans	19.00		13.75	
Unsecured Personal Loans	19.75	(20.75)	18.25	
Citibank (New York State), N.A. (Buffalo)				
No changes in rates.				

TABLE 7 (concluded)

CHANGES IN RATES AND FEES CHARGED ON CONSUMER LOANS BY LARGE COMMERCIAL BANKS IN UPSTATE NEW YORK SINCE SEPTEMBER 15, 1982

	Rates and Fees Charged	
	Sept. 15, 1982	November 1982
Liberty National Bank (Buffalo)		
Home Improvement Loans	18.00 %	17.00 %
New Car Loans	18.00	16.50
Used (under 2 yrs.) Car Loans	19.00	17.00
Used (over 2 yrs.) Car Loans	19.00	17.00
Second Mortgage Loans	18.00	16.50
Loans Secured by Savings Accts.	19.00	16.00
Unsecured Personal Loans	19.00	17.00
Manufacturers & Traders Trust Co. (Buffalo)		
Home Improvement Loans	18.00	17.00
New Car Loans	18.00	17.00
Used (under 2 yrs.) Car Loans	18.00	17.00
Used (over 2 yrs.) Car Loans	18.00	17.00
Second Mortgage Loans	18.39	16.25
Loans Secured by Savings Accts.	18.00	17.00
Unsecured Personal Loans	18.00	17.00
Marine Midland Bank, N.A. (Buffalo)		
Home Improvement Loans	18.00 (19.80)	16.00 (18.00)
New Car Loans	18.00 (19.80)	16.00 (18.00)
Second Mortgage Loans	18.00 (19.80)	16.50 (16.50)

NOTE: Some banks charge higher rates to persons who have no deposit or other relationships with that bank. In the cases where this occurs, those higher rates are indicated in parentheses.

TABLE 8

ANNUAL PERCENTAGE RATES
ON VARIOUS TYPES OF CONSUMER LOANS
LARGE COMMERCIAL BANKS
IN NEW YORK CITY
November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans*
Bank of New York	18.25 % (19.75)	14.50 %	19.00 % (20.50)
Chase Manhattan Bank, N.A.	18.25	17.75	17.25-18.25
Chemical Bank	17.50 (18.50)	17.00 (18.00)	17.00-17.50 (18.00-18.50)
Citibank, N.A.	19.00 (21.00)	18.00 (20.00)	18.00-19.00 (20.00-21.00)
European American Bank	16.50 (19.00)	16.50 (19.00)	16.50 (19.00)
Irving Trust Co.	17.75 (18.00)	17.75 (18.00)	17.75 (18.00)
Manufacturers Hanover Trust Co.	18.00	17.00 (18.00)	16.50 (18.00)
National Bank of North America	17.00 (19.00)	17.00 (19.00)	17.00 (19.00)
Republic National Bank	18.50 (20.50)	17.50 (19.50)	18.50 (20.50)

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* Where two used car rates are indicated for any one bank, the first is for loans on used cars less than 2 years old; the second is for loans on cars 2 years old or more.

TABLE 8 (continued)

ANNUAL PERCENTAGE RATES
ON VARIOUS TYPES OF CONSUMER LOANS
LARGE COMMERCIAL BANKS
IN NEW YORK CITY
November 1982

	Second Mortgage Loans	Loans Secured by Savings Accts.	Overdraft Checking Loans	Unsecured Personal Loans
Bank of New York	15.50 *% (17.00)*	17.50 %	19.80 %	19.00 % (20.50)
Chase Manhattan Bank, N.A.	14.50	19.00	19.50	19.00
Chemical Bank	16.50 ** (17.50)**	15.50	19.50	18.00 (19.00)
Citibank, N.A.	17.05 (19.05)	18.00	19.50	19.00 (21.00)
European American Bank	-	10.27	18.10	17.50 (20.00)
Irving Trust Co.	-	17.75	18.00	18.75 (19.00)
Manufacturers Hanover Trust Co.	17.67 (18.18)	16.50	19.80	18.00 (19.00)
National Bank of North America	-	16.00	18.00	18.00 (19.00)
Republic National Bank	-	16.00	18.00	18.50 (20.50)

* Plus 3 points.

** Plus 2 points.

TABLE 8 (concluded)

ANNUAL PERCENTAGE RATES AND FEES
ON CREDIT CARDS
LARGE COMMERCIAL BANKS
IN NEW YORK CITY
November 1982

	Credit Card			
	Purchases	Cash Advances	Annual Fees	Other Charges
Bank of New York	19.80 %	19.80 %	$12.00	-
Chase Manhattan Bank, N.A.	18.00	18.00	15.00	25 cents per cash advance
Chemical Bank	19.50	19.50	20.00	75 cents per cash advance
Citibank, N.A.	19.80	19.80	20.00	-
European American Bank	18.00	18.00	None (15.00)	-
Irving Trust Co.	19.80	19.80	20.00	-
Manufacturers Hanover Trust Co.	19.80	19.80	15.00	-
National Bank of North America	19.00	19.00	None (15.00)	25 cents per cash advance
Republic National Bank	-	-	-	-

NOTE: Some banks charge higher rates to persons who have no deposit or other relationships with that bank. In the cases where this occurs, those higher rates are indicated in parentheses. Some rates and fees indicated in this Table are effective December 1, 1982 or January 1, 1983.

TABLE 9

ANNUAL PERCENTAGE RATES ON CONSUMER CREDIT LARGE COMMERCIAL BANKS WITH OFFICES IN THE ALBANY METROPOLITAN AREA November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans
Bankers Trust of Albany, N.A.	17.00 %	16.00 %	17.00 %
Key Bank N.A.	16.00	16.00	16.00
State Bank of Albany	15.00	15.00	15.00
Bank of New York	18.25 (19.75)	14.50	19.00 (20.50)
Chemical Bank	17.50 (18.50)	17.00 (18.00)	17.00-17.50 (18.00-18.50)
Citibank (New York State), N.A.	19.00	18.00	19.00
Manufacturers Hanover, N.A.	17.50	15.50	17.50
Marine Midland Bank, N.A.	16.00 (18.00)	16.00 (18.00)	18.00 (19.80)

	Second Mortgage Loans	Loans Secured by Savings Accts.	Overdraft Checking Loans	Unsecured Personal Loans
Bankers Trust of Albany, N.A.	17.00 %	16.00 %	18.00 %	17.00 %
Key Bank N.A.	16.50	16.00	18.00	16.00
State Bank of Albany	16.00	16.00	18.00	16.00
Bank of New York	15.50 * (17.00)*	17.50	19.80	19.00 (20.50)
Chemical Bank	16.50 ** (17.50)**	15.50	19.50	18.00 (19.00)
Citibank (New York State), N.A.	16.75	-	20.00	19.00
Manufacturers Hanover, N.A.	-	17.50	18.00	17.50
Marine Midland Bank, N.A.	16.50	18.00	19.80	18.00 (19.80)

* Plus 3 points.

** Plus 2 points.

TABLE 9 (concluded)

ANNUAL PERCENTAGE RATES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN THE ALBANY METROPOLITAN AREA
November 1982

	Credit Card			
	Purchases	Cash Advances	Annual Fees	Other Charges
Bankers Trust of Albany, N.A.	18.00 %	18.00 %	$15.00	-
Key Bank N.A.	18.00	18.00	15.00	-
State Bank of Albany	18.00	18.00	15.00	-
Bank of New York	19.80	19.80	12.00	-
Chemical Bank	19.50	19.50	20.00	75 cents per cash advance
Citibank (New York State), N.A.	19.80	19.80	20.00	-
Manufacturers Hanover, N.A.	-	-	-	-
Marine Midland Bank, N.A.	19.80	19.80	15.00	-

NOTE: Some banks charge higher rates to persons who have no deposit or other relationships with that bank. In the cases where this occurs, those higher rates are indicated in parentheses.

TABLE 10

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN THE UTICA METROPOLITAN AREA
November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans
Oneida National Bank	17.00 %	15.00 %	16.50-16.75 %
Bankers Trust of Albany, N.A.	17.00	16.00	17.00
Chemical Bank	17.50 (18.50)	17.00 (18.00)	17.00-17.50 (18.00-18.50)
Citibank (New York State), N.A.	19.00	18.00	19.00
Key Bank of Central N.Y.	15.75 (16.25)	15.50 (16.00)	17.50 (18.00)
Lincoln First Bank, N.A. (Central)	14.40 (15.40)	13.40 (14.40)	14.40 (15.40)
Marine Midland Bank, N.A.	16.00 (18.00)	16.00 (18.00)	18.00 (19.80)

	Second Mortgage Loans	Loans Secured by Savings Accts.	Overdraft Checking Loans	Unsecured Personal Loans
Oneida National Bank	17.75 %	13.00 %	19.80 %	17.75 %
Bankers Trust of Albany, N.A.	17.00	16.00	18.00	17.00
Chemical Bank	16.50 * (17.50)*	15.50	19.50	18.00 (19.00)
Citibank (New York State), N.A.	16.75	-	20.00	19.00
Key Bank of Central N.Y.	16.00 (16.50)	18.00	18.00	18.00 (18.50)
Lincoln First Bank, N.A. (Central)	-	-	18.00	14.90 (15.90)
Marine Midland Bank, N.A.	16.50	18.00	19.80	18.00 (19.80)

* Plus 2 points.

TABLE 10 (concluded)

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN THE UTICA METROPOLITAN AREA
November 1982

	Credit Card			
	Purchases	Cash Advances	Annual Fees	Other Charges
Oneida National Bank	19.80 %	19.80 %	$15.00	-
Bankers Trust of Albany, N.A.	18.00	18.00	15.00	-
Chemical Bank	19.50	19.50	20.00	75 cents per cash advance
Citibank (New York State), N.A.	19.80	19.80	20.00	-
Key Bank of Central N.Y.	19.80	19.80	15.00	-
Lincoln First Bank, N.A. (Central)	19.50	19.50	15.00	-
Marine Midland Bank, N.A.	19.80	19.80	15.00	-

NOTE: Some banks charge higher rates to persons who have no deposit or other relationships with that bank. In the cases where this occurs, those higher rates are indicated in parentheses.

TABLE 11

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN THE SYRACUSE METROPOLITAN AREA
November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans
Key Bank of Central New York	15.75 % (16.25)	15.50 % (16.00)	17.50 % (18.00)
Merchants National Bank	17.00	15.50	17.00
Bank of New York	18.25 (19.75)	14.50	19.00 (20.50)
Bankers Trust of Albany, N.A.	17.00	16.00	17.00
Chemical Bank	17.50 (18.50)	17.00 (18.00)	17.00-17.50 (18.00-18.50)
Citibank (New York State), N.A.	19.00	18.00	19.00
Lincoln First Bank, N.A. (Central)	14.40 (15.40)	13.40 (14.40)	14.40 (15.40)
Manufacturers Hanover, N.A.	17.50	15.50	17.50
Marine Midland Bank, N.A.	16.00 (18.00)	16.00 (18.00)	18.00 (19.80)
Oneida National Bank	17.00	15.00	16.50-16.75

TABLE 11 (continued)

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN THE SYRACUSE METROPOLITAN AREA
November 1982

	Second Mortgage Loans	Loans Secured by Savings Accts.	Overdraft Checking Loans	Unsecured Personal Loans
Key Bank of Central New York	16.00 % (16.50)	18.00 %	18.00 %	18.00 % (18.50)
Merchants National Bank	-	16.00	17.50	17.00
Bank of New York	15.50 * (17.00)*	17.50	19.80	19.00 (20.50)
Bankers Trust of Albany, N.A.	17.00	16.00	18.00	17.00
Chemical Bank	16.50 ** (17.50)**	15.50	19.50	18.00 (19.00)
Citibank (New York State), N.A.	16.75	-	20.00	19.00
Lincoln First Bank, N.A. (Central)	-	-	18.00	14.90 (15.90)
Manufacturers Hanover, N.A.	-	17.50	18.00	17.50
Marine Midland Bank, N.A.	16.50	18.00	19.80	18.00 (19.80)
Oneida National Bank	17.75	13.00	19.80	17.75

* Plus 3 points.

** Plus 2 points.

TABLE 11 (concluded)

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN THE SYRACUSE METROPOLITAN AREA
November 1982

	Credit Card			
	Purchases	Cash Advances	Annual Fees	Other Charges
Key Bank of Central New York	19.80 %	19.80 %	$15.00	-
Merchants National Bank	-	-	-	-
Bank of New York	19.80	19.80	12.00	-
Bankers Trust of Albany, N.A.	18.00	18.00	15.00	-
Chemical Bank	19.50	19.50	20.00	75 cents per cash advance
Citibank (New York State), N.A.	19.80	19.80	20.00	-
Lincoln First Bank, N.A. (Central)	19.50	19.50	15.00	-
Manufacturers Hanover, N.A.	-	-	-	-
Marine Midland Bank, N.A.	19.80	19.80	15.00	-
Oneida National Bank	19.80	19.80	15.00	-

NOTE: Some banks charge higher rates to persons who have no deposit or other relationships with that bank. In the cases where this occurs, those higher rates are indicated in parentheses.

TABLE 12

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT LARGE COMMERCIAL BANKS WITH OFFICES IN ROCHESTER METROPOLITAN AREA November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans
Central Trust Co.	18.00 %	16.00 %	18.00 %
	(20.00)	(18.00)	(20.00)
Lincoln First Bank, N.A.	18.00	16.50	17.50
	(19.00)	(17.50)	(18.50)
Manufacturers Hanover, N.A.	17.50	15.50	17.50
Security Trust Co.	15.75	14.75	16.75-17.75
	(16.25)	(15.25)	(17.25-18.25)
Chemical Bank	17.50	17.00	17.00-17.50
	(18.50)	(18.00)	(18.00-18.50)
Citibank (New York State), N.A.	19.00	18.00	19.00
Key Bank of Central N.Y.	15.75	15.50	17.50
	(16.25)	(16.00)	(18.00)
Liberty National Bank	17.00	16.50	17.00
Marine Midland Bank, N.A.	16.00	16.00	18.00
	(18.00)	(18.00)	(19.80)
Oneida National Bank	17.00	15.00	16.50-16.75

TABLE 12 (continued)

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT LARGE COMMERCIAL BANKS WITH OFFICES IN ROCHESTER METROPOLITAN AREA

November 1982

	Second Mortgage Loans	Loans Secured by Savings Accts.	Overdraft Checking Loans	Unsecured Personal Loans
Central Trust Co.	-	-	18.00 %	18.00 % (20.00)
Lincoln First Bank, N.A.	-	16.50 %	18.00	16.50 (17.50)
Manufacturers Hanover, N.A.	-	17.50	18.00	17.50
Security Trust Co.	13.75 %	-	18.00	18.25
Chemical Bank	16.50 * (17.50)*	15.50	19.50	18.00 (19.00)
Citibank (New York State), N.A.	16.75	-	20.00	19.00
Key Bank of Central N.Y.	16.00 (16.50)	18.00	18.00	18.00 (18.50)
Liberty National Bank	16.50	16.00	18.00	17.00
Marine Midland Bank, N.A.	16.50	18.00	19.80	18.00 (19.80)
Oneida National Bank	17.75	13.00	19.80	17.75

* Plus 2 points.

TABLE 12 (concluded)

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN ROCHESTER METROPOLITAN AREA
November 1982

	Credit Card			
	Purchases	Cash Advances	Annual Fees	Other Charges
Central Trust Co.	18.00 %	18.00 %	-	-
Lincoln First Bank, N.A.	19.50	19.50	$15.00	-
Manufacturers Hanover, N.A.	-	-	-	-
Security Trust Co.	16.00-18.00 *	16.00	15.00	-
Chemical Bank	19.50	19.50	20.00	75 cents per cash advance
Citibank (New York State), N.A.	19.80	19.80	20.00	-
Key Bank of Central N. Y.	19.80	19.80	15.00	-
Liberty National Bank	18.00	18.00	15.00	-
Marine Midland Bank, N.A.	19.80	19.80	15.00	-
Oneida National Bank	19.80	19.80	15.00	-

* 18% on first $500; 16% over $500.

NOTE: Some banks charge higher rates to persons who have no deposit or other relationships with that bank. In the cases where this occurs, those higher rates are indicated in parentheses.

TABLE 13

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN THE BUFFALO METROPOLITAN AREA
November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans
Citibank (New York State), N.A.	19.00 %	18.00 %	19.00 %
Liberty National Bank	17.00	16.50	17.00
Manufacturers & Traders Trust Co.	17.00	17.00	17.00
Marine Midland Bank, N.A.	16.00 (18.00)	16.00 (18.00)	18.00 (19.80)
Bank of New York	18.25 (19.75)	14.50	19.00 (20.50)
Chemical Bank	17.50 (18.50)	17.00 (18.00)	17.00-17.50 (18.00-18.50)
Manufacturers Hanover, N.A.	17.50	15.50	17.50

	Second Mortgage Loans	Loans Secured by Savings Accts.	Overdraft Checking Loans	Unsecured Personal Loans
Citibank (New York State), N.A.	16.75 %	-	20.00 %	19.00 %
Liberty National Bank	16.50	16.00 %	18.00	17.00
Manufacturers & Traders Trust Co.	16.25	17.00	19.80	17.00
Marine Midland Bank, N.A.	16.50	18.00	19.80	18.00 (19.80)
Bank of New York	15.50 * (17.00)*	17.50	19.80	19.00 (20.50)
Chemical Bank	16.50 ** (17.50)**	15.50	19.50	18.00 (19.00)
Manufacturers Hanover, N.A.	-	17.50	18.00	17.50

* Plus 3 points.

** Plus 2 points.

TABLE 13 (concluded)

ANNUAL PERCENTAGE RATES AND CHARGES ON CONSUMER CREDIT
LARGE COMMERCIAL BANKS
WITH OFFICES IN THE BUFFALO METROPOLITAN AREA
November 1982

	Credit Card			
	Purchases	Cash Advances	Annual Fees	Other Charges
Citibank (New York State), N.A.	19.80 %	19.80 %	$20.00	-
Liberty National Bank	18.00	18.00	15.00	-
Manufacturers & Traders Trust Co.	19.80	19.80	15.00	-
Marine Midland Bank, N.A.	19.80	19.80	15.00	-
Bank of New York	19.80	19.80	12.00	-
Chemical Bank	19.50	19.50	20.00	75 cents per cash advance
Manufacturers Hanover, N.A.	-	-	-	-

* Plus 3 points.

** Plus 2 points.

NOTE: Some banks charge higher rates to persons who have no deposit or other relationships with that bank. In the cases where this occurs, those higher rates are indicated in parentheses.

B. Savings Banks

Responses were received from 92 savings banks, of which 63 were headquartered outside New York City and 29 were headquartered in the City. Some of the banks did not report interest rates on all types of loans for all the dates specified in the questionnaire either because they were not legally empowered to make such loans or did not offer certain types of loans.

The survey revealed that interest rates on home improvement, automobile, second mortgage and unsecured personal loans declined somewhat on average during 1982, while rates trended upward during the period covered by the survey in the case of loans secured by savings accounts and overdraft checking loans (Tables 14 to 16). For most types of loans, rates in New York City usually averaged higher than those upstate and there were substantial variations in rates charged by different institutions.

On conventional home improvement loans, the average interest rate statewide rose from 15.6% on January 2, 1981 to 18.6% by January 2, 1982. However, many banks reduced their rates during 1982 so that the average declined to 17.8% by September 15, 1982.

A similar pattern was evident in 1982 for rates on automobile loans, both for new and used cars, which declined on average during 1982. As a result of the Omnibus Banking Bill granting savings banks the authority to make automobile loans, 67 savings banks statewide were offering new car loans by September 1982, and 66 were making used car loans.

There was also a substantial number of institutions statewide offering second mortgage loans (61 banks) and unsecured personal instalment loans (60 banks) by September 1982. The average rate on these loans declined during 1982 as many banks reduced their rates.

In the case of instalment loans secured by regular savings or DOD/DOW accounts, as well as overdraft checking, average rates trended upward during the period covered by the survey. The number of savings banks offering overdraft checking services increased from 37 to 46 between January 1981 and September 1982. Almost none of the banks offer credit card plans.

The rates charged on educational loans to students, or to parents of students, guaranteed by the New York State Higher Education Services Corporation, were all at the legal maximum during the period covered by the survey. Educational loans to parents of students, guaranteed by the NYSHESC starting in October 1981, were being offered by 46 savings banks by September 1982. Ninety-two banks were making guaranteed loans to students.

All respondents indicated that their loan rates were uniform at all offices and most indicated that their rates on any given type of loan were the same for all customers. Those that reported differences indicated that non-depositors paid a higher rate than depositors.

Most savings banks reported that they had not altered their credit standards or increased their maximum credit lines since February 1981. However, three-quarters of the banks indicated that they had increased their participation in consumer lending. This largely reflected the fact that, as indicated previously, the number of savings banks making car loans, second mortgage loans, overdraft loans, unsecured personal loans and educational loans to parents of students increased during the period covered by the survey.

The telephone survey made in November 1982 of a sample of New York City and upstate savings banks indicated that five of the six banks contacted had cut certain of their consumer loan rates since September 15, 1982. These rate cuts were mainly on home improvement loans, automobile loans, second mortgage loans and unsecured personal loans (Table 17). A wide range of rates was also evident (Table 18).

TABLE 14

ANNUAL PERCENTAGE RATES
ON HOME IMPROVEMENT LOANS AND CAR LOANS
SAVINGS BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Conventional Home Improvement Loans						
Average Rate	15.22 %	19.33 %	18.41 %	15.68 %	18.35 %	17.60 %
Range of Rates	12.00-19.00	17.00-21.00	17.50-20.00	11.90-19.00	16.00-22.00	14.00-20.00
New Car Loans						
Average Rate	-	18.25	17.90	-	17.63	17.00
Range of Rates	-	17.00-19.50	16.75-19.00	-	16.00-20.00	14.00-19.00
Loans on Cars Less Than 2 Years Old						
Average Rate	-	18.95	18.41	-	18.27	17.67
Range of Rates	-	17.50-20.00	17.00-20.00	-	17.00-20.00	14.00-19.50
Loans on Cars 2 Years Old or More						
Average Rate	-	19.00	18.50	-	18.44	17.88
Range of Rates	-	17.50-20.00	17.50-20.00	-	17.00-22.00	14.00-21.00

TABLE 15

ANNUAL PERCENTAGE RATES
ON EDUCATION LOANS
SAVINGS BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
	Loans to Students Guaranteed by NYSHESC					
Average Rate	9.00 %	9.00 %	9.00 %	9.00 %	9.00 %	9.00 %
Range of Rates	9.00- 9.00	9.00- 9.00	9.00- 9.00	9.00- 9.00	9.00- 9.00	9.00- 9.00
	Loans to Parents Guaranteed by NYSHESC					
Average Rate	-	14.00	14.00	-	14.00	14.00
Range of Rates	-	14.00- 14.00	14.00- 14.00	-	14.00- 14.00	14.00- 14.00

TABLE 16

ANNUAL PERCENTAGE RATES ON OTHER TYPES OF CONSUMER LOANS SAVINGS BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Second Mortgage Loans						
Average Rate	-	18.69 %	17.98 %	-	18.20 %	17.54 %
Range of Rates	-	17.00-20.25	15.75-20.25	-	16.00-19.50	15.00-20.67
Loans Secured by Regular or DOD/DOW Accounts						
Average Rate	9.27 %	11.27	11.45	10.46 %	12.38	12.40
Range of Rates	7.50-16.00	7.50-19.00	7.50-19.00	6.50-16.00	6.50-19.00	6.50-19.00
Overdraft Checking Loans						
Average Rate	12.50	16.13	17.67	12.41	16.50	17.51
Range of Rates	12.00-18.00	12.00-18.00	12.00-19.00	12.00-18.00	12.00-20.00	12.00-20.00
Unsecured Personal Loans						
Average Rate	-	19.45	19.21	-	18.70	18.18
Range of Rates	-	18.50-20.50	18.00-20.50	-	17.00-22.00	14.00-21.00

TABLE 17

CHANGES IN RATES CHARGED BY SAVINGS BANKS ON CONSUMER LOANS SINCE SEPTEMBER 15, 1982

	Rates Charged	
	Sept. 15, 1982	November 1982
Dime Savings Bank of N. Y.		
Home Improvement Loans	17.5 %	17.0 %
New Car Loans	19.0	17.0
Unsecured Personal Loans	19.5	18.0
Dry Dock Savings Bank		
Home Improvement Loans	18.5(20.5)	17.0(19.0)
New Car Loans	18.0(20.0)	15.5(17.5)
Used (under 2 yrs.) Car Loans	18.5(20.5)	16.5(18.5)
Used (over 2 yrs.) Car Loans	18.5(20.5)	17.0(19.0)
Loans Secured by Savings Accounts	16.0	14.5
Unsecured Personal Loans	18.5(20.5)	17.0(19.0)
Seamen's Bank for Savings		
No changes in rates.		
Empire of America, F.S.A.		
Home Improvement Loans	18.5	16.5
New Car Loans	17.0	15.5
Used Car Loans	18.5	17.5
Second Mortgage Loans	15.4	13.5
Rochester Savings Bank		
Home Improvement Loans	17.5	15.5
New Car Loans	18.0	16.5
Used Car Loans	18.0	16.5
Second Mortgage Loans	16.0	14.0
Syracuse Savings Bank		
New Car Loans	18.0	16.0
Used Car Loans	18.0	16.0
Second Mortgage Loans	18.0	16.0
Unsecured Personal Loans	18.0	16.0

NOTE: Dry Dock Savings Bank charges higher rates on certain loans to persons who have no deposit relationship with the bank. In the cases where this occurs, those higher rates are indicated in parentheses.

TABLE 18

ANNUAL PERCENTAGE RATES ON CONSUMER LOANS SELECTED SAVINGS BANKS IN NEW YORK STATE November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans
New York City Banks			
Dime Savings Bank of N.Y.	17.00 %	17.00 %	-
Dry Dock Savings Bank	17.00	15.50	16.50-17.00 %
	(19.00)	(17.50)	(18.50-19.00)
Seamen's Bank for Savings	-	18.00	18.00
Upstate Banks			
Rochester Savings Bank	15.50	16.50	16.50
Syracuse Savings Bank	-	16.00	16.00
Empire Savings, F.S.A. (Buffalo)	16.50	15.50	17.50

	Second Mortgage Loans	Overdraft Checking Loans	Loans Secured by Savings Accts.	Unsecured Personal Loans
New York City Banks				
Dime Savings Bank of N.Y.	-	18.00 %	10.75 %	18.00 %
Dry Dock Savings Bank	15.75 %	-	14.50	17.00
				(19.00)
Seamen's Bank for Savings	18.00	18.00	9.00	19.00
Upstate Banks				
Rochester Savings Bank	14.00	18.00	13.00	18.00
Syracuse Savings Bank	16.00	18.00	12.00	16.00
Empire Savings, F.S.A.(Buffalo)	13.50	-	12.00	19.50

TABLE 18 (concluded)

ANNUAL PERCENTAGE RATES
ON CONSUMER LOANS
SELECTED SAVINGS BANKS
IN NEW YORK STATE
November 1982

Guaranteed Education Loans

New York City Banks	To Students	To Parents of Students
Dime Savings Bank of N.Y.	9.00 %	12.00 %
Dry Dock Savings Bank	9.00	-
Seamen's Bank for Savings	9.00	-
Upstate Banks		
Rochester Savings Bank	9.00	12.00
Syracuse Savings Bank	9.00	-
Empire Savings, F.S.A. (Buffalo)	9.00	12.00

NOTES: Only one of these banks (Empire Savings) offered a credit card plan. One bank (Dry Dock Savings Bank) charges higher rates on certain loans to persons who have no deposit relationship. In the cases where this occurs, those higher rates are indicated in parentheses.

C. Savings and Loan Associations

Responses were received from 65 savings and loan associations, of which 45 were headquartered outside New York City and 20 were in the City. Virtually none of the respondents offered credit cards and some associations did not offer other types of loans specified on the questionnaire form.

Generally, average interest rates on home improvement loans increased during 1981 but declined somewhat during 1982; rates on new car loans fell during 1982; and there were steady upward movements in average rates throughout the period covered by the survey for loans secured by savings accounts and overdraft checking loans (Tables 19 to 21). For most types of loans, rates in New York City usually averaged higher than those upstate and there were substantial variations in rates charged by different institutions.

On conventional home improvement loans, the average interest rate statewide rose from 15.6% on January 2, 1981 to 18.1% by January 2, 1982. However, many associations reduced their rates during 1982 so that the average declined to 17.6% by September 15, 1982.

A similar pattern was evident in 1982 for new car loans, which declined on average during 1982. By September 1982, 15 associations statewide were offering new car loans and 13 were making used car loans.

There was an even more substantial involvement in second mortgage loans, with 36 institutions offering them by September 1982. The average rate declined during 1982 as many associations cut their rates.

In the case of instalment loans secured by regular savings or DOD/DOW accounts, as well as overdraft checking, average rates trended upward during the period covered by the survey. Nine associations were offering overdraft checking services by September 1982 and 16 institutions were making unsecured personal instalment loans. Almost none of the associations offered credit card plans.

The rate charged on educational loans to students, or to parents of students, guaranteed by the New York State Higher Education Services Corporation were all at the legal maximum throughout the period covered by the survey. Guaranteed educational loans to students were being offered by 43 associations in September 1982 and 21 associations were making guaranteed loans to parents of students.

All respondents indicated that their loan rates were uniform at all offices and almost all indicated that their rates for any specific type of loan were the same for all customers.

Only a few institutions indicated they had liberalized their credit standards or increased their maximum credit lines since February 1981 although 29% reported they had increased their participation in consumer lending. As noted above, a number of associations were making car loans, second mortgage loans, unsecured personal loans and guaranteed educational loans by September 1982.

The telephone survey made in November 1982 of a sample of New York City and upstate savings and loan associations indicated that five of the six associations reduced certain of their rates. These included rates on home improvement loans, automobile loans, second mortgage loans and unsecured personal loans (Table 22). Some rate variations were also evident (Table 23).

TABLE 19

ANNUAL PERCENTAGE RATES
ON HOME IMPROVEMENT LOANS AND CAR LOANS
SAVINGS AND LOAN ASSOCIATIONS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Conventional Home Improvement Loans						
Average Rate	16.00 %	18.75 %	18.29 %	15.54 %	17.96 %	17.51 %
Range of Rates	15.00-17.00	18.00-20.00	17.50-20.00	12.00-19.00	15.00-20.00	15.50-20.00
New Car Loans						
Average Rate	17.00*	18.67	18.50	-	17.79	17.23
Range of Rates	17.00-17.00	18.00-20.00	16.50-20.00	-	16.50-19.50	15.00-19.50
Loans on Cars Less Than 2 Years Old						
Average Rate	17.00*	18.67	18.88	-	18.10	17.94
Range of Rates	17.00-17.00	18.00-20.00	18.00-20.00	-	17.00-19.00	16.50-20.00
Loans on Cars 2 Years Old or More						
Average Rate	17.00*	18.00	18.67	-	18.42	18.15
Range of Rates	17.00-17.00	18.00-18.00	18.00-20.00	-	17.00-20.00	16.50-20.00

* Only one respondent offered car loans on January 2, 1981.

TABLE 20

ANNUAL PERCENTAGE RATES
ON EDUCATION LOANS
SAVINGS AND LOAN ASSOCIATIONS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Loans to Students Guaranteed by NYSHESC						
Average Rate	9.00 %	9.00 %	9.00 %	9.00 %	9.00 %	9.00 %
Range of Rates	9.00-9.00	9.00-9.00	9.00-9.00	9.00-9.00	9.00-9.00	9.00-9.00
Loans to Parents Guaranteed by NYSHESC						
Average Rate	-	14.00	14.00	-	14.00	14.00
Range of Rates	-	14.00-14.00	14.00-14.00	-	14.00-14.00	14.00-14.00

TABLE 21

ANNUAL PERCENTAGE RATES
ON OTHER TYPES OF CONSUMER LOANS
SAVINGS AND LOAN ASSOCIATIONS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Second Mortgage Loans						
Average Rate	-	18.19 %	17.58 %	15.68 %	18.31 %	17.48 %
Range of Rates	-	17.50-18.95	15.00-18.95	15.00-16.00	16.00-20.03	15.50-20.00
Loans Secured by Regular or DOD/DOW Accounts						
Average Rate	8.91 %	9.38	9.79	8.95	9.24	9.29
Range of Rates	7.50-12.00	7.50-12.00	7.50-15.00	6.50-16.00	6.50-19.00	6.50-18.50
Overdraft Checking Loans						
Average Rate	-	19.50*	19.50*	15.72	17.80	18.25
Range of Rates	-	19.50-19.50	19.50-19.50	12.16-18.00	17.00-18.00	18.00-20.00
Unsecured Personal Loans						
Average Rate	18.00	19.38	19.14	-	19.08	18.83
Range of Rates	17.00-19.00	18.00-21.00	17.50-21.00	-	18.00-20.50	17.00-20.50

* Only one respondent offered overdraft checking loans.

TABLE 22

CHANGES IN RATES CHARGED BY SAVINGS AND LOAN ASSOCIATIONS ON CONSUMER LOANS SINCE SEPTEMBER 15, 1982

	Rates Charged	
	Sept. 15, 1982	November 1982
Edison Federal SLA		
New Car Loans	20.0 %	19.0 %
Used Car Loans	20.0	19.0
Second Mortgage Loans	18.0	17.0
Unsecured Personal Loans	21.0	20.0
Financial Federal SLA		
Second Mortgage Loans	15.0	14.0
Washington Federal SLA		
Unsecured Personal Loans	17.5	16.0
Eastman SLA		
Home Improvement Loans	17.0	16.0
Second Mortgage Loans	16.25	15.75
Homestead SLA		
No changes in rates.		
Schenectady Federal SLA		
Home Improvement Loans	17.5	16.0

TABLE 23

ANNUAL PERCENTAGE RATES
ON CONSUMER LOANS
SELECTED SAVINGS AND LOAN ASSOCIATIONS
IN NEW YORK STATE
November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans
New York City Associations			
Edison Federal SLA	-	19.00 %	19.00 %
Financial Federal SLA	-	-	-
Washington Federal SLA	-	-	-
Upstate Associations			
Eastman SLA (Rochester)	16.00 %	-	-
Homestead SLA (Utica)	18.00	-	-
Schenectady Federal SLA	16.00	-	-

	Second Mortgage Loans	Overdraft Checking Loans	Loans Secured by Savings Accts.	Unsecured Personal Loans
New York City Associations				
Edison Federal SLA	17.00 %	-	11.00 %	20.00 %
Financial Federal SLA	14.00	-	12.00	-
Washington Federal SLA	-	-	10.00	16.00
Upstate Associations				
Eastman SLA (Rochester)	15.75	18.00 %	-	-
Homestead SLA (Utica)	18.00	-	8.50	-
Schenectady Federal SLA	-	-	8.50	-

TABLE 23 (concluded)

ANNUAL PERCENTAGE RATES
ON CONSUMER LOANS
SELECTED SAVINGS AND LOAN ASSOCIATIONS
IN NEW YORK STATE
November 1982

Guaranteed Education Loans

New York City Associations	To Students	To Parents of Students
Edison Federal SLA	-	-
Financial Federal SLA	-	-
Washington Federal SLA	9.00 %	-
Upstate Associations		
Eastman SLA (Rochester)	9.00	12.00 %
Homestead SLA (Utica)	9.00	12.00
Schenectady Federal SLA	9.00	12.00

NOTE: Only one of these associations offered credit card plans.

D. Credit Unions

Responses were received from 54 credit unions, of which 36 were headquartered outside New York City and 18 were in the City. Some of the institutions did not report interest rates on all types of loans for all the dates specified in the questionnaire.

Generally, interest rates on the various types of consumer loans offered by the reporting credit unions trended upward during the period covered by the survey (Tables 24 to 26). Rates in New York City usually averaged higher than those upstate and there were substantial variations in rates charged by different institutions.

On conventional home improvement loans, the average interest rate statewide rose from 14.0% on January 2, 1981 to 15.3% by January 2, 1982 to 15.4% by September 15, 1982.

Similar patterns were evident for automobile loans, second mortgage loans, loans secured by savings accounts and unsecured personal instalment loans. Almost none of the credit unions offered credit card plans.

In the case of overdraft checking, the average rate statewide rose from 16.0% to 17.6% by January 2, 1982 but declined to 17.3% by September 15, 1982.

The rates charged on educational loans to students or to parents of students, guaranteed by the New York State Higher Education Services Corporation, were at the maximum permitted.

All respondents indicated that their loan rates were uniform at all offices and almost all indicated that their rates were the same for all customers.

Most credit unions reported that they had not altered their credit standards or increased their maximum credit lines since February 1981. However, 30% of the respondents indicated that they had increased their participation in consumer lending.

On most types of loans, credit unions charged lower interest rates, on average, than did commercial banks, savings banks, savings and loan associations, licensed lenders, retailers or car dealers.

The telephone survey made in November 1982 of a sample of credit unions indicated that four of the six credit unions contacted had reduced certain of their loan rates since September 15, 1982 (Table 27). Substantial rate variations were also indicated (Table 28).

TABLE 24

ANNUAL PERCENTAGE RATES ON HOME IMPROVEMENT LOANS AND CAR LOANS CREDIT UNIONS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Conventional Home Improvement Loans						
Average Rate	15.89 %	16.89 %	16.89 %	12.92 %	14.44 %	14.66 %
Range of Rates	12.00- 24.00	12.00- 24.00	12.00- 24.00	10.08- 16.00	10.52- 19.00	11.00- 18.00
New Car Loans						
Average Rate	15.65	16.94	16.94	12.89	14.00	14.18
Range of Rates	12.00- 18.00	13.00- 20.37	13.00- 20.37	9.96- 21.00	9.96- 19.00	11.00- 19.00
Loans on Cars Less than 2 Years Old						
Average Rate	16.01	17.08	17.08	12.99	14.15	14.45
Range of Rates	12.00- 20.00	14.00- 20.00	14.00- 20.00	9.72- 21.00	9.72- 19.00	11.00- 19.00
Loans on Cars 2 Years Old or More						
Average Rate	16.01	17.08	17.08	13.07	14.16	14.48
Range of Rates	12.00- 20.00	14.00- 20.00	14.00- 20.00	9.72- 21.00	9.72- 19.00	11.00- 19.00

TABLE 25

ANNUAL PERCENTAGE RATES ON EDUCATION LOANS CREDIT UNIONS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Loans to Students Guaranteed by NYSHESC						
Average Rate	9.00 %*	9.00 %*	9.00 %*	9.00 %	9.00 %	9.00 %
Range of Rates	9.00-9.00	9.00-9.00	9.00-9.00	9.00-9.00	9.00-9.00	9.00-9.00
Loans to Parents Guaranteed by NYSHESC						
Average Rate	-	-	-	-	14.00	14.00
Range of Rates	-	-	-	-	14.00-14.00	14.00-14.00

* Only one respondent offered student loans.

TABLE 26

ANNUAL PERCENTAGE RATES ON OTHER TYPES OF CONSUMER LOANS CREDIT UNIONS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
	Second Mortgage Loans					
Average Rate	16.69 %	17.44 %	17.44 %	14.25 %	15.00 %	15.80 %
Range of Rates	16.00-18.00	16.00-20.00	16.00-20.00	12.00-17.00	12.00-17.00	15.00-18.00
	Loans Secured by Regular or DOD/DOW Accounts					
Average Rate	13.44	13.99	13.99	11.50	11.87	12.07
Range of Rates	9.60-24.00	10.80-24.00	10.80-24.00	6.00-21.00	6.00-18.00	6.00-18.00
	Overdraft Checking Loans					
Average Rate	-	-	-	16.00	17.63	17.30
Range of Rates	-	-	-	12.00-21.00	16.00-19.75	16.00-19.00
	Unsecured Personal Loans					
Average Rate	14.12	15.50	15.57	12.78	14.11	14.73
Range of Rates	7.00-18.00	9.00-20.00	11.50-18.00	9.00-18.00	9.00-19.00	9.00-19.00

TABLE 27

CHANGES IN RATES CHARGED BY CREDIT UNIONS ON CONSUMER LOANS SINCE SEPTEMBER 15, 1982

	Rates Charged	
	Sept. 15, 1982	November 1982
American Airlines Credit Union		
New Car Loans	14.0 %	12.0 %
Used Car Loans	14.0	12.0
Hyfin Credit Union		
No changes in rates.		
Self Reliance Federal Credit Union		
Home Improvement Loans	15.0	14.4
New Car Loans	16.2	15.0
Used Car Loans	16.8	16.2
Second Mortgage Loans	16.8	16.2
Unsecured Personal Loans	16.8	16.2
IBM Kingston Federal Credit Union		
Home Improvement Loans	14.0	12.0
New Car Loans	14.0	11.75
Used (under 2 yrs.) Car Loans	15.0	12.75
Used (over 2 yrs.) Car Loans	16.0	13.75
Overdraft Checking Loans	16.0	14.0
Unsecured Personal Loans	17.0	16.0
IBM Poughkeepsie Federal Credit Union		
Home Improvement Loans	17.0	13.5(variable
Second Mortgage Loans	18.0	13.5(variable
State Employees Federal Credit Union		
No changes in rates.		

TABLE 28

ANNUAL PERCENTAGE RATES ON CONSUMER LOANS SELECTED CREDIT UNIONS IN NEW YORK STATE November 1982

	Conventional Home Improvement Loans	New Car Loans	Used Car Loans
In New York City			
American Airlines C.U.	14.00 %	12.00 %	12.00 %
Hyfin C.U.	17.00	17.00	18.00
Municipal C.U.	17.00	15.00	15.00
Self Reliance Fed. C.U.	14.40	15.00	16.20
Outside New York City			
IBM Kingston Employees Fed. C.U.	12.00	11.75	12.75-13.75
IBM Poughkeepsie Employees Fed. C.U.	13.50*	14.00	18.00
State Employees Fed. C.U.	17.50	16.50	17.50

	Second Mortgage Loans	Overdraft Checking Loans	Loans Secured by Savings Accts.	Unsecured Personal Loans
In New York City				
American Airlines C.U.	-	-	12.00 %	14.00 %
Hyfin C.U.	18.00 %	-	14.00	18.00
Municipal C.U.	-	-	11.00	17.00
Self Reliance Fed. C.U.	16.20	-	10.80	16.20
Outside New York City				
IBM Kingston Employees Fed. C.U.	15.00	14.00 %	9.25	16.00
IBM Poughkeepsie Employees Fed. C.U.	13.50*	18.00	10.00	18.00
State Employees Fed. C.U.	-	17.50	10.00	17.50

* Variable rate loans.

NOTE: Three of these credit unions (Self Reliance and the two IBM credit unions) make guaranteed education loans, all at the maximum rates permitted.

E. Licensed Lenders

A total of 31 licensed lenders responded to the questionnaire survey, most of which had offices only outside New York City. Not all lenders made all the types of loans indicated on the questionnaire forms.

In general, the survey indicated that most of the respondents were at the 25% legal maximum by January 1981 for car loans and for personal loans, both secured and unsecured, and have remained at that level up to September 15, 1982. There were wide variations, however, in interest rates charged on second mortgage loans (Table 29).

During 1982, the average interest rates on second mortgage loans declined statewide from 21.3% to 20.5%. By September 1982, 16 lenders were making these loans.

All but one of the respondents indicated that their rates on all types of loans were uniform at all offices for all customers.

Most lenders reported that, since February 1981, they have not liberalized credit standards or raised credit lines although 40% stated they had increased their participation in consumer lending.

The telephone survey made in November 1982 of a sample of licensed lenders indicated that three of the four lenders had reduced certain of their rates since September 15 (Table 30). Some rate variations were evident, particularly for second mortgage loans (Table 31).

TABLE 29

ANNUAL PERCENTAGE RATES ON LOANS LICENSED LENDERS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
Car Loans						
Average Rate	23.00 %	25.00 %	25.00 %	24.33 %	24.67 %	24.17 %
Range of Rates*	-	-	-	18.00-25.00	24.00-25.00	18.00-25.00
Other Secured Loans						
Average Rate	24.33	25.00	25.00	24.11	24.63	24.74
Range of Rates	23.00-25.00	25.00-25.00	25.00-25.00	18.00-25.00	24.00-25.00	24.00-25.00
Unsecured Personal Loans						
Average Rate	24.50	25.00	25.00	23.62	24.40	24.34
Range of Rates	23.00-25.00	25.00-25.00	25.00-25.00	18.00-25.00	19.80-25.00	19.80-25.00
Second Mortgage Loans						
Average Rate	-	22.22	20.54	-	21.03	20.47
Range of Rates	-	21.00-23.43	18.50-22.00	-	17.54-23.00	17.54-23.00

* Only one respondent in New York City made car loans.

NOTE: Four of the five respondents with offices in New York City also have offices outside New York City. Those lenders tabulated as being outside New York City have no offices in the City.

TABLE 30

CHANGES IN RATES CHARGED BY LICENSED LENDERS ON CONSUMER LOANS SINCE SEPTEMBER 15, 1982

	Rates Charged	
	Sept. 15, 1982	November 1982
AVCO Financial Services		
No changes in rates.		
Barclays American Financial Inc.		
Second Mortgage Loans	19.5 %	18.0 %
Beneficial Finance Co.		
Unsecured Personal Loans	25.0	23.0
Household Finance Corp.		
Second Mortgage Loans	21.2	20.2

TABLE 31

ANNUAL PERCENTAGE RATES ON CONSUMER LOANS SELECTED MAJOR LICENSED LENDERS IN NEW YORK STATE November 1982

	Car Loans	Other Secured Loans	Unsecured Personal Loans	Second Mortgage Loans
Avco Financial Services	-	25.00 %	25.00 %	22.00 %
Barclays American Financial Inc.	18.00 %	25.00	25.00	18.00
Beneficial Finance Co.	25.00	25.00	23.00	20.45
Household Finance Corp.	-	-	25.00	20.22

F. Retailers

Responses were received from 15 retailers who had their own credit or charge plans. Of these, 12 were located outside New York City.

The rates charged by these retailers on their revolving credit accounts generally trended upward during the period covered by the survey (Table 32). On indebtedness of $500 or less, the average rate statewide was almost 18% in January 1981, rose to 20.1% in January 1982 and to 20.6% in September 1982. On balances over $500, the average rates were 12.9%, 17.9% and 19.1% on the three dates covered in the survey.

The respondents reported that their rates were uniform at all their places of business in New York State.

Most of the respondent retailers did not offer close-end credit. Of the few that did, all indicated their rates were the same as for their revolving credit accounts.

In addition, all but one respondent said either that there were no monthly charges levied on 30-day accounts (where the total outstanding balance is due and payable by the next payment date) or that they did not offer such accounts.

Virtually all the retailers indicated that they did not change their credit standards or credit lines since February 1981 nor did they increase their participation in consumer lending.

None of the six retailers contacted by phone in November 1982 reported any changes in their rates since September 15, 1982. The November 1982 rates for these retailers are listed in Table 33.

TABLE 32

ANNUAL PERCENTAGE RATES
ON CONSUMER CREDIT
AT RETAILERS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
	Indebtedness of $500 or Less					
Average Rate	18.00 %	19.60 %	19.60 %	18.00 %	20.28 %	20.82 %
Range of Rates	18.00-18.00	18.00-21.00	18.00-21.00	17.96-18.00	17.96-24.00	17.96-24.00
	Indebtedness of Over $500					
Average Rate	12.00	19.60	19.60	13.09	17.39	19.02
Range of Rates	12.00-12.00	18.00-21.00	18.00-21.00	12.00-18.00	12.00-24.00	12.00-24.00

TABLE 33

ANNUAL PERCENTAGE RATES
ON CONSUMER CREDIT
SELECTED RETAILERS
IN NEW YORK STATE
November 1982

	Instalment Credit or Store Charge Cards		Annual Fees Or Other Charges
	Credit of $500 or Less	Credit over $500	
New York City Retailers			
B. Altman & Co.	18.00 %	18.00 %	-
Ohrbach's, Inc.	19.80	19.80	-
J. C. Penney Co., Inc.	21.00	21.00	-
Upstate Retailers			
Bruce Hall Corp. (Cooperstown)	24.00	24.00	-
Harry T. Mangurian, Inc. (Rochester)	21.50	21.50	-
Carl Co. (Schenectady)	19.80	19.80	-

NOTE: All of these retailers either did not offer 30-day accounts or levied no charges for such accounts.

G. Automobile Dealers

Responses were obtained from 58 automobile dealers, almost all of whom were outside New York City. Not all the dealers reported information on all the types of automobile financing covered in the questionnaire.

Overall, the survey revealed that average rates on automobile loans, both for new and used cars, increased during 1981 but declined during 1982. There were also substantial variations in rates among dealers (Table 34).

On new car loans, the average interest rate statewide was slightly over 17% in January 1981. A majority of the respondents increased their rates during 1981 so that the average in January 1982 stood at 17.9%. During 1982, however, a number of dealers cut their rates so that the average declined to 17.5% by September 1982. Similar patterns were evident for used car loans.

Virtually all the respondents indicated that their rates were uniform at all their places of business for all their customers.

The preponderance of the dealers reported no liberalization of credit standards since February 1981 although 26% of them reported increased participation in consumer lending activities since that date.

During the course of 1982, the financing arms of the major automobile manufacturers cut their rates for various periods of time for certain of their cars. For example, at the end of March, General Motors announced a 12.8% rate to buyers of its new cars for the next two months. In early November, it cut its rate to

10.9%, from 18%, on 1982 models in order to help reduce dealers' inventories. Ford Motor Credit Company announced a rate cut to 10.75% early in November to finance purchases of its 1982 Ford, Lincoln and Mercury models which will continue through December 31. Earlier in the year, Ford had offered an 11.9% rate for specific models for a period of time. Chrysler cut its rates to 10.9% on certain 1982 and 1983 models in November and this rate will apply until the end of 1982.

Six of the seven car dealers included in the sample telephone survey in November 1982 reported that they had reduced their rates on automobile loans since September 15, 1982. For five of the six dealers, the rate reductions applied to both new cars and some older cars (Table 35). Some rate variations was also indicated (Table 36).

TABLE 34

ANNUAL PERCENTAGE RATES
AUTOMOBILE DEALERS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982	Jan. 2, 1981	Jan. 2, 1982	Sept. 15, 1982
New Car Loans						
Average Rate	16.50 %	18.63 %	18.25 %	17.22 %	17.81 %	17.43 %
Range of Rates	12.68-18.48	18.00-19.00	17.50-19.00	12.90-19.34	15.00-19.25	13.00-19.00
Loans on Cars Less Than 2 Years Old						
Average Rate	19.38	20.67	20.17	19.93	20.31	19.91
Range of Rates	17.68-21.00	20.50-21.00	19.00-21.00	16.00-23.44	15.00-24.50	13.00-23.65
Loans on Cars 2 Years Old or More						
Average Rate	20.91	22.67	22.17	21.65	21.93	21.73
Range of Rates	17.68-24.00	21.50-24.00	20.00-24.00	17.00-24.50	18.00-25.00	18.00-25.00

TABLE 35

CHANGES IN RATES CHARGED BY CAR DEALERS
SINCE SEPTEMBER 15, 1982

	Rates Charged	
	Sept. 15, 1982	November 1982
Avoxe Corporation		
No changes in rates.		
Crystal Oldsmobile, Inc.		
New Car Loans	18.0 %	16.5 %
Universal Ford, Inc.		
New Car Loans	18.5	17.75
Used (over 2 yrs.) Car Loans	24.0	23.0
Miller Motor Car Corporation		
New Car Loans	19.0	17.0
Used (under 2 yrs.) Car Loans	21.0	19.0
Used (over 2 yrs.) Car Loans	21.0	19.0
George Smith Motors, Inc.		
New Car Loans	18.0	16.0
Used (under 2 yrs.) Car Loans	21.0	20.0
Used (over 2 yrs.) Car Loans	23.0	22.0
Sherwood Smith Motors, Inc.		
New Car Loans	17.6	15.5
Used (under 2 yrs.) Car Loans	22.0	19.0
Used (over 2 yrs) Car Loans	25.0	21.0
Joseph Spector Cadillac		
New Car Loans	16.75	15.75
Used (over 2 yrs.) Car Loans	21.0	20.0

TABLE 36

ANNUAL PERCENTAGE RATES ON CAR LOANS SELECTED AUTOMOBILE DEALERS IN NEW YORK STATE November 1982

	New Car Loans	Used Car Loans	
		Cars Under 2 yrs. old	Cars 2 yrs. old or more
New York City Dealers			
Avoxe Corporation	19.00 %	20.50 %	22.50 %
Crystal Oldsmobile, Inc.	16.50	-	-
Universal Ford, Inc.	17.75	21.00	23.00
Upstate Dealers			
Miller Motor Car Corp. (Binghamton)	17.00	19.00	19.00
George E. Smith Motors, Inc. (Batavia)	16.00	20.00	22.00
Sherwood Smith Motors, Inc. (Johnstown)	15.50	19.00	21.00
Joseph Spector Cadillac (Syracuse)	15.75	17.50	20.00

IV. BANKING DEPARTMENT'S CONSUMER EDUCATION PROGRAM

In light of the findings of this survey indicating that banks are continuing to offer a wide range of rates and fees, thereby providing consumers with alternative choices, it is particularly significant that the Banking Department embarked on a broad campaign immediately after passage of the Omnibus Banking Bill in November 1980 to educate the public about the new law and urge that consumers shop for credit.

As part of this campaign, the Department developed a brochure entitled "Shopping for Credit - A Consumer Guide for Credit in New York State" and distributed almost 5 million copies. The brochure, structured in question and answer form, addressed many of the questions consumers have had about the law and urged them to shop for the best credit deal available. The New York Telephone Company notified all of their New York State customers of the availability of this "Shopping for Credit" brochure and all TV, radio and news publications located in New York State were sent a copy of the brochure with a personal request from the Superintendent that they inform their audiences of the brochure's availability.

In conjunction with the distribution of the brochure, the Department received generous assistance from the Outdoor Advertising Association of New York State which arranged for free billboard space throughout the State urging the public to shop for credit and indicating the availability of the Department's brochure.

The Department also received from the New York City Transit Authority a public service donation of advertising space on subway cars for 6,000 advertising posters whose content was the same as the billboard posters.

In addition, as part of our ongoing program of educating the consumer to the rapidly changing world of banking, the Department instituted an "outreach" program which included a free seminar designed to help the public better understand banking. Five such seminars have been held around the State during 1982. The seminars were designed to explain some of the new types of deposit accounts and loans, including second mortgage loans, that are being offered by banking institutions and to attempt to resolve any personal problems that any member of the public may have had with financial institutions in New York State.

FINANCIAL INSTITUTIONS BUREAU

DECLINE OF THE MICHIGAN REGULATORY LOAN INDUSTRY

Michigan Department of Commerce
September 1982

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I. INTRODUCTION

As in many other states, there exists in Michigan a species of non-depository lender which specializes in relatively small consumer loans. Michigan was among the first six states to recognize the need for a legal source of small amounts of cash credit and to enact legislation permitting establishment of small loan companies. The intent of the law was to eliminate loan sharks by serving the credit demands of "needy and necessitous borrowers" through regulated lenders. To encourage formation of small loan companies, limitations on interest rates were set at levels which would enable the companies to operate profitably and which "would be reasonable to borrowers in view of the risk and other costs involved." (The Consumer Finance Industry: Its Costs and Regulation, John M. Chapman and Robert P. Shay, eds., Columbia University Press, 1967, p. 13)

Let us examine the legislative history of the small loan industry.

A. 1915 PA 228; Loan limit of $300; Rate of 3% per month for loans of $100 or less and 2% per month for loans in excess of $100.

B. 1921 PA 317; Loan limit of $300; Rate of 3% per month for loans of $100 or less and 2% per month for loans in excess of $100; repealed previous act.

C. 1925 PA 181; Loan limit of $300; Rate of 3½% per month on all unpaid balances; amended previous act.

D. 1939 PA 21; Loan limit of $300; Rate of 3% per month on the portion of the unpaid balance of loan which is $100 or less and 2½% per month on the unpaid balance in excess of $100; repealed previous act.

E. 1947 PA 130; Loan limit of $500; Rate of 3% per month on portion of unpaid balance of $50 or less; 2½% per month on portion of unpaid balance in excess of $50 but not in excess of $300; 0.75% per month on portion of unpaid balance in excess of $300; amended previous act.

F. 1963 PA 103; Loan limit of $1,000; Rate of 2½% per month on portion of unpaid balance of $300 or less; 1¼% per month on portion of unpaid balance in ekcess of $300; amended previous act.

G. 1971 PA 168; Loan limit of $1,500; Rate of 2½% per month on portion of unpaid balance of $400 or less; 1¼% per month on portion of unpaid balance in excess of $400; amended previous act.

H. 1978 PA 528; Loan limit of $3,000; Rate of 31% per year on the portion of the unpaid principal balance amounting to $500 or less and 13% per year on the portion of the unpaid principal balance in excess of $500 (does not apply to a loan secured by a motor vehicle 2 or less model years old), or 18% per year on the unpaid principal balance of $3,000 or less; amended previous act.

I. 1980 PA 392; Prohibited the assignment of wages as security for regulatory loans; amended previous act.

For the first time in many years, Michigan has fewer than 200 licensed regulatory loan offices. The 123 offices existing on September 1, 1982 constituted a mere 17.8% of the 1968 peak level of 691. About 75% of existing regulatory loan licensees have ceased granting new loans, and most of the others limit loans to $1,000.00 or less. Many large chains are liquidating their Michigan holdings because Michigan regulations do not permit them to operate profitably.

The heavy burden of regulation placed upon small loan companies (particularly ceilings on loan interest rates and loan amounts) with the intent of protecting financially unsophisticated borrowers has limited their ability to serve "needy and necessitous borrowers." At current levels, loan size and rate ceilings have made it impossible for small loan companies to operate profitably in Michigan, and they are leaving the state.

II. NUMBER OF LICENSEES AND THEIR LOAN ACTIVITIES SINCE 1960

Table I shows the number of licensees, the number of accounts they held, and the average number of accounts per licensee each year since 1960. The number of licensees has fallen fairly steadily since 1968, with one brief reversal in 1972. (Note that in 1971, the loan ceiling was increased by 50% (from $1,000 to $1,500) and the amount to which the highest rate applied rose from $300 to $400.)

TABLE I

Number of Accounts and Number of Licensees, 1960-1981
(Source: Abstract of Reports of Regulatory Loan Licensees for 1960-1976;
Annual Report of the Financial Institutions Bureau for 1981)

Year	Average Number of Open Accounts	Number of Licensees	Average Number of Accounts Per Licensee
1960	564,635	549	1,028
1961	577,507	584	989
1962	575,293	604	952
1963	558,107	608	918
1964	545,355	634	860
1965	556,009	657	846
1966	569,905	675	844
1967	577,769	677	853
1968	577,297	691	835
1969	590,516	676	873
1970	582,830	626	931
1971	552,895	595	929
1972	517,277	597	866
1973	507,000	593	855
1974	497,916	550	905
1975	452,205	461	981
1976	396,373	415	955
1977	376,552	387	973
1978	379,277	375	1,011
1979	365,658	350	1,044
1980	329,028	271	1,214
1981	261,054	165	1,582

In 1981, the average number of open accounts fell to its lowest level during the twenty year period, 261,054 accounts. This represents declines from the 1960 and 1969 levels of 53.8% and 55.8%, respectively. Most of the decline is due to restrictive ceilings on interest rates and loan size which discourage licensees from making regulatory loans. Trends in assets devoted to the regulatory loan business support this view. These assets declined (in nominal as well as real terms) in six of the 12 years since 1968. But in 1972 and 1979, following statutory increases in rate and amount ceilings, regulatory loan assets showed substantial growth.

One factor that may have contributed to the decline in numbers of accounts was consolidations of separate accounts made possible by the loan amount ceiling increases in 1972 and 1978. Another possible reason for the decline in number of accounts handled by small loan companies was the competition offered by other types of financial institutions. For example, widespread issuance of credit cards by retailers and all types of financial institutions has provided an easily accessible source of credit. The credit card is a less costly and more convenient means of using credit to complete transactions. Its versatility enables cardholders to charge small dollar purchases or, if they desire, more costly items such as consumer durables, since a line of credit of $3,000 is not unusual.

TABLE 2

Trend in Total Assets of Small Loan Licensees, 1964-1981
(Source: Annual Report, Financial Institutions Bureau Calendar Year 1981)

	Regulatory Loan Licensees	
Year	Total Assets Assets Used in Regulatory Loan Business	% Increase (Decline) From Previous Year
1968	361,472,000	
1969	375,677,000	3.9%
1970	362,977,000	(3.4)
1971	332,869,000	(8.3)
1972	395,869,000	18.9
1973	423,428,000	7.0
1974	400,879,000	(5.3)
1975	358,013,000	(10.7)
1976	333,955,000	(6.7)
1977	338,863,000	1.5
1978	347,157,000	2.4
1979	428,277,000	23.4
1980	347,227,000	(18.9)
1981	235,113,000	(32.3)

Since the market for consumer cash credit is segmented by the credit source and the borrower's credit risk, it is unlikely that competition from other credit sources has caused the decline in numbers of small loans. This segmentation is caused in part by differences in legal interest rate ceilings and maximum loan amounts available to various types of financial institutions and, in part, by the fact that different types of credit grantors choose to serve specific segments of the consumer credit market. (The allowable interest rate, the degree of perceived credit risk, and size of the loan are factors in lenders' decisions to serve certain market segments.)

While average humber of open accounts fell between 1960 and 1981, the average number of accounts per licensee rose 18.1% during that period. Between 1960 and 1968, as number of licensees rose, the average number of accounts per licensee fell from 1,028 to 835. Then from 1976 through 1981 it increased rapidly. Much of the latter increase can be explained by recent declines in number of licensees. Many licensees which closed their offices sold their accounts to other licensees. Some chain companies merged the accounts of closed offices with those of their remaining offices. While there remained fewer offices, the average office in 1981 held more accounts than it did prior to 1976.

Table 3 shows the percentage shares of the nationwide consumer credit market - both loans outstanding and new credit extensions - held by various types of lenders over time. Nationwide, in 1972, finance companies (including consumer finance companies, sales finance companies, industrial banks, and industrial loan companies) provided 23.4% of new consumer credit extended and held 23.9% of outstanding consumer installment credit. During the 1970's, finance companies' share of new consumer credit extensions dropped below 17.0%, but climbed slowly back to 19.9% in 1980. Finance companies' share of outstanding consumer credit balances fell below 20.0% during the '70's but rebounded in 1980 to 24.5%. Between 1972 and 1980, credit unions' share of the outstanding consumer installment credit nationwide increased from 12.8% to 14.0%, savings and loan associations' share rose from 0.9% to 3.2%, retailers' share dropped from 11.3% to 9.4%, and commercial banks' share fell from 48.4% to 46.5% (though it rose above 49.0% on several occasions in the late '70s).

TABLE 3

Consumer Installment Credit Outstanding and Extensions Nationwide
Percentage by Holder, Selected Years 1972-1980
(Source: Dollar Amounts Provided in Finance Facts Yearbook 1981, National Consumer Finance Association)

	1972	1975	1977	1978	1979	1980
Outstanding at Year End-Total	100%	100%	100%	100%	100%	100%
Commercial Banks	48.4	48.2	48.7	49.7	49.4	46.5
Finance Companies	23.9	20.9	19.5	19.8	21.9	24.5
Credit Unions	12.8	14.9	16.3	16.2	14.9	14.0
Retailers	11.3	10.6	10.2	9.5	9.0	9.4
Savings & Loans	0.9	2.8	3.1	2.6	2.7	3.2
Gasoline Companies	1.9	1.6	1.3	1.2	1.2	1.5
Mutual Savings Banks	0.8	1.0	0.9	1.0	0.9	0.9
Extensions During Year-Total	100%	100%	100%	100%	100%	100%
Commercial Banks	41.9	44.9	45.8	47.8	47.6	43.7
Finance Companies	23.4	17.3	16.3	17.0	18.9	19.9
Credit Unions	10.5	13.4	13.2	12.8	10.8	9.7
Retailers	15.2	15.2	16.4	15.0	14.7	16.7
Savings and Loans	0.5	1.5	1.9	1.2	1.8	2.1
Gasoline Companies	7.8	6.9	5.7	5.4	5.6	7.3
Mutual Savings Banks	0.7	0.8	0.7	0.8	0.6	0.6

III. STATISTICAL REVIEW OF EARNINGS: TIME SERIES DATA (1960-1981)

Table 4 presents time series data for total loans outstanding and earnings of small loan companies during the period 1960 to 1981. The data show that the total loans outstanding for the industry peaked at $422,111,000 in 1979, after which total loans declined to $231,386,000 in 1981. Total dollar net earnings after interest paid but before income taxes (NEAIBIT) reached its highest levels in 1964 ($12,458,000) and 1965 ($13,107,000). During the period 1960-1965, NEAIBIT as a percentage of average invested assets remained fairly stable and never fell below 3.31 percent. From 1966 to 1973, NEAIBIT as a percentage of average invested assets varied between 1.24 percent in 1971 and 2.73 percent in 1967 (except for 1970, when this percentage dropped to 0.37). The final years of this period saw the ratio of NEAIBIT to average invested assets reach negative values in 1974 and 1975, climb to 1.18 percent in 1977, and plummet to -5.06 percent in 1981.

TABLE 4
Comparative Summary of Loans Outstanding and Earnings 1960-1981

Year	Loans Outstanding Dec. 31**	Average Invested Assets**	Total Revenue**	Non-Interest Expense**	Net Earnings Before Interest & Income Taxes (NEBIIT)*	Interest Paid**	Net Earnings After Interest But Before Income Taxes (NEAIBIT)**	NEAIBIT As A Percent Of Average Invested Assets
1960	$177,036	$187,369	$43,254	$26,854	$16,401	$ 8,503	$ 7,989	4.22%
1961	177,369	188,741	44,356	28,789	15,567	8,610	6,957	3.69
1962	181,240	186,000	44,632	29,727	14,906	7,604	7,302	3.93
1963	248,081	205,070	47,426	32,076	15,350	8,554	6,796	3.31
1964	281,583	271,983	58,194	33,614	24,579	12,121	12,458	4.58
1965	304,700	301,897	63,065	36,054	27,012	13,905	13,107	4.34
1966	323,872	323,615	66,405	39,892	26,572	21,626	4,946	1.53
1967	334,674	338,074	66,485	41,665	24,820	15,600	9,220	2.73
1968	345,413	347,609	69,727	44,501	25,225	16,945	8,280	2.38
1969	357,969	362,409	72,584	45,846	26,738	19,772	6,966	1.92
1970	346,625	365,306	72,396	48,957	23,439	22,105	1,334	0.37
1971	332,115	381,379	69,991	45,734	24,257	19,518	4,739	1.24
1972	384,025	397,046	74,381	47,818	26,563	20,646	5,917	1.49
1973	412,347	433,592	81,820	47,541	34,279	25,552	8,757	2.02
1974	391,783	445,643	83,432	51,625	31,780	31,879	(99)	(0.02)
1975	349,687	406,339	74,904	50,730	24,174	26,253	(2,079)	(0.51)
1976	326,921	356,701	68,222	44,997	23,225	21,765	1,460	0.41
1977	332,526	351,956	67,324	40,827	26,497	22,329	4,168	1.18
1978	341,166	358,333	69,277	40,402	28,875	24,904	3,971	1.11
1979	422,111	401,148	77,141	46,610	30,530	32,619	(2,089)	(0.52)
1980	342,213	402,574	74,500	46,584	27,916	37,122	(9,206)	(2.29)
1981	231,386	302,724	56,803	38,819	17,984	33,312	(15,328)	(5.06)

*For the years 1960-1970, NEBIIT reflected the net earnings for the small loan industry before payment of interest and federal taxes but after state and local taxes were paid. From 1970 to the present, NEBIIT reflected the net earnings before payment of interest and all income taxes, state and federal. Therefore, the net earnings figures for the two periods (1960-1970 and 1971-present) are not strictly comparable; i.e, the net earnings figures for the former period are biased downward, though the amount of this bias is very small.

**(000 omitted)

These figures indicate a long-term decline in the profitability of the small loan industry in Michigan. The most important factor contributing to this decline was the long-term rise in interest paid by the small loan industry. Interest paid increased 55.5 percent between 1965 to 1966. During the last 20 years interest paid climbed from $7,604,000 in 1962 to a peak of $37,122,000 in 1980, an increase of 388.2 percent, before dropping to $33,312,000 in 1981. Loans outstanding increased only 28% between 1962 and 1981.

Interest paid reached record levels in 1979 and 1980, years in which the NEAIBIT as a percentage of average invested assets was negative. In 1974 and 1975, one notes the same pattern of record high levels of interest paid and negative values of NEAIBIT as a percentage of average invested assets. Based on these data, it appears that interest expense has had a significant effect on the profitability of the small loan industry.

Another factor which has seriously affected licensees' profitability is the recent federal Bankruptcy Act which took effect October 1, 1979. This law allows a person to retain more of his/her possessions (including household goods which are often accepted as collateral for small loans) after bankruptcy and makes it more difficult to reaffirm a debt. In 1980, Andrew Brimmer conducted a survey of 1,645 individuals and families who had filed bankruptcy and found that 57% of the people in the sample were 34 years of age and under. This age group constituted 40% of the population 18 years old and over. The 18 to 44 year old group made up 56% of the working age population but 83% of the bankruptcy cases in the sample. This has serious implications for regulatory loan licensees which deal largely with a relatively youthful market segment.

Structural Changes in Small Loan Industry

The capital invested in the small loan industry tends to be highly mobile. If the rate of return on invested capital is higher in a given industry (or in a different area in the same industry), then one could reasonably assume that funds would flow out of the area of low return into the area (i.e., another state) of higher return. This flow of invested capital would be reflected in the decline (increase) in the number of firms in the area of low (high) return. Mobility of funds in a particular industry (i.e., small loan industry) also implies that potential entrants will not enter an industry in an area (a state) where the rate of return is lower than can be earned elsewhere.

Data in Michigan support this view. The downward trend in the number of small loan licensees was clearly depicted in Table 1, above. As of September 1, 1982, the number of licensees had fallen to 123.

IV. LOAN CEILING: APPRAISAL

It is well known that the administrative costs of making a loan are relatively fixed; that is, are independent of the dollar amount loaned. For example, it costs as much to make a $100 loan as a $3,000 loan. This fact has important implications for small loan companies in Michigan, since the current statute requires that they specialize in relatively small loans. For a given total dollar amount loaned, small loan companies must make a larger number of loans (each costing nearly as much to make as a larger loan) than other types of lenders which are not faced with restrictive legal constraints on loan size. The dollar interest earned on a loan must be sufficient to cover not only the interest cost of the funds extended, but also the fixed costs of putting the loan on the books and the cost of bad debt losses. For the smaller amount loaned, the ratio of operating costs per dollar loaned is higher than for a larger loan. To cover all of these costs, other lenders' larger loans may subsidize their smaller loans, but companies which make only small loans must charge interest rates which are above the levels charged by other types of lenders.

Table 5 depicts the trend in monthly expense per account during the period 1968-1981. These data show a substantial rise in monthly expense per account, with much of the increase occurring after 1972. Over this fourteen year period, the monthly expense per account rose from $7.32 to $10.82, an increase of 47.8%, before slipping to $10.15 in 1981. The comparable percentage rise from 1972-1981 was 25.2%.

TABLE 5

Trend in Monthly Expense per Account (1968-1981)
(Source: Abstracts of Reports of Regulatory Loan Licensees for 1968-1981)

Year	Average Monthly Expense Per Account
1968	$ 7.32
1969	7.52
1970	8.04
1971	8.29
1972	8.11
1973	8.41
1974	8.75
1975	8.21
1976	9.66
1977	9.49
1978	9.42
1979	10.45
1980	10.82
1981	10.15

Additionally, small loan companies serve higher risk customers, so that their collection costs and bad debt losses tend to be higher than for other types of financial institutions for which the level of risk assumed is lower.

In Michigan, because of restrictive interest ceilings, all licensees charge interest at the statutory maximum rate, which restricts their ability to adjust to increases in costs. Costs, of course, have increased since the last statutory ceiling increase due to inflation. Since "price" adjustments are legally proscribed, small loan companies must adjust in other ways, such as reducing their level of risk exposure (through non-price rationing of marginal credit risks) and in some instances by granting larger loans (this enables them to lower the fixed costs per dollar loaned; i.e., "spread the overhead"). Due to the low loan ceiling in Michigan, the second option is often not available. (Small loan licensees in Michigan may loan more than $3,000, but must comply with the state's general usury ceiling of 7% per annum which effectively prohibits the making of larger loans.) One would, therefore, expect that small loan licensees would raise their credit standards (which would result in a greater proportion of loans denied); that is, they attempt to reduce the risk assumed by limiting their credit extensions to low risk borrowers. Though there are no hard data available showing the trend in the number of denials to total loan applications processed, for more than a year, some licensees have reported denial rates exceeding 90%.

Alternatively, lenders might insist on more stringent credit terms (additional security). Table 6 describes the proportion of secured and unsecured loans made during the period 1970-1981.

TABLE 6
Summary of Loans Made (1970-1981)*

(Source: Abstracts of Reports of Regulatory Loan Licensees, 1970-1976,
Annual Reports of The Financial Institutions Bureau, 1977-1981)

Year	Secured	Unsecured
1970	77.4%	22.6%
1971	80.3	19.7
1972	87.6	12.4
1973	86.3	13.7
1974	86.3	13.7
1975	86.1	13.9
1976	87.4	12.6
1977	86.4	13.6
1978	85.3	14.7
1979	90.7	9.3
1980	90.5	9.5
1981	85.4	14.6

*Percentages are determined by dollar amounts devoted to each type of loan.

These data show that unsecured loans as a percentage of total loans made declined during the period from a high of 22.6% in 1970 to a low of 9.3% in 1979. Loans which were secured by automobiles and household goods accounted for much of the proportionate increase in secured loans. The amount of loans secured by wage assignments (no longer permitted for new credit extensions) fell to $2,326,000 in 1981 from $39,662,000 five years earlier.

The need for consumer credit has increased dramatically since the Regulatory Loan Act was originally enacted. Consumer credit is more socially accepted today than in 1915, and consumers depend heavily on credit in financing their purchases of major appliances, furniture, automobiles and other consumer durables, medical services and housing. In recent years, the Consumer Price Index and the price indexes for food, fuel, and other necessities have risen rapidly. Customers of small loan companies, on average, have incomes below the national median and spend a relatively large portion of their disposable incomes on necessities. (See "Borrower Profile" on page 22)

Based on the foregoing discussion, an increase in the loan ceiling is warranted. Certainly the recent trend in inflation supports this view. As originally enacted in 1915, the Regulatory Loan Act provided for a loan limit of $300. Since 1915, the real personal disposable income of consumers has increased significantly. With higher levels of income, consumers can afford to carry a higher level of debt. While the present loan ceiling constitutes a greater amount of real purchasing power than the 1939 ceiling ($300), it is questionable whether $3,000 in 1982 adequately serves the credit needs of many consumers. Using data on consumer prices published in the Federal Reserve Bulletin, one can show that the purchasing power of $3,000 in 1979 dollars is less than $2,300 in 1982.

In inflationary times a loan amount ceiling ensures that the market segment served by licensees will shrink. That is, most people will need more credit than a licensee can legally lend. Elimination of the loan amount ceiling would assure that licensees could continue to meet the credit needs of their traditional market segment. In its Final Report, the Governor's Advisory Commission on the Regulation of Financial Institutions recommended:

> "THAT THE CURRENT LEGAL RESTRICTIONS ON THE TERM (DURATION) AND AMOUNT OF NON-BUSINESS LOANS TO INDIVIDUALS ... BE REMOVED."

Loan Ceilings in Other States

It is difficult to make comparisons between Michigan's Regulatory Loan Act and small loan statutes in other states, in part, because laws are changing rapidly, and, in part, because some states, including Michigan, allow licensees to lend money under more than one statute. Table 7 was compiled from information provided by the National Consumer Finance Association in its November, 1981 publication, Summary of Consumer Credit Laws and Rates.

As shown in Table 7, in November 1981 33 states were reported as having higher small loan amount ceilings than Michigan's $3,000 limit. Of these, six had no ceilings and another 18 had ceilings of $10,000 or more. Among the 16 states which were reported as having small loan ceilings of $3,000 or less, 15 had other laws which permitted licensees to make loans in larger amounts. In Michigan's case, this alternative loan authority is more illusory than real under present economic conditions. Michigan's Secondary Mortgage Act, which took effect in 1981, allows licensed lenders to make loans in excess of $3,000 at a maximum interest rate of 15% per year. Small loan companies may become licensed under the act, but few have done so because of the low interest rate ceiling on such loans. Few, if any, loans have yet been made under the Secondary Mortgage Act.

TABLE 7: Comparison of Statutory Amount Ceilings on Small Loans in Other States

(Source: National Consumer Finance Association,
Summary of Consumer Credit Laws and Rates,
November, 1981)

State	Small Loan Amount Ceiling	Other State Law Which Permits Licensees a Higher Amount Ceiling
Alabama	$ 749	Consumer Credit Act-No Ceiling
Alaska	25,000	
Arizona	10,000	
California	None	
Colorado, UCCC	25,000	
Connecticut	5,000	
Delaware	500 or 10% of capital over $10,000	
Florida	25,000	Interest parity law - $50,000
Georgia	3,000	
Hawaii	300	Industrial Loan Act-No Ceiling
Idaho, UCCC	55,000	
Illinois	3,000	Installment Loan Act - $25,000
Indiana, UCCC	45,000	
Iowa	2,000	Industrial Loan Act - 20% of capital
Kansas, UCCC	25,000	
Kentucky	2,000	Industrial Loan Act - $10,000
Louisiana	None	
Maine, UCCC	45,000	
Maryland	6,000	
Massachusetts	6,000	
Michigan	3,000	Secondary Mortgage-Over $3,000
Minnesota	35,000	Industrial Loan Law-10% of Capital and Reserve
Mississippi	None	
Missouri	None	
Montana	25,000	
Nebraska	7,000	Industrial Loan Law - 20% of capital, surplus capital notes and debentures
Nevada	10,000	
New Hampshire	10,000	
New Jersey	5,000	
New Mexico	2,500	Installment Loan Law-No Ceiling
New York	4,000	Second Mortgage Law-No Ceiling
North Carolina	5,000	Installment Loan Law - $25,000
North Dakota	1,000	Consumer Finance Act-$15,000
Ohio	3,000	Second Mortgage Act-No Ceiling
Oklahoma, UCCC	45,000	
Oregon	50,000	
Pennsylvania	None	
Rhode Island	2,500	Second Mortgage Loan-No Ceiling
South Carolina, UCCC	32,500	Mortgage Loan-No Ceiling
South Dakota	30,000	
Tennessee	10% of net worth	
Texas	6,250	Consumer Credit Code-No Ceiling
Utah, UCCC	55,000	Mortgage Loan-No Ceiling
Vermont	3,000	Second Mortgage-No Ceiling
Virginia	2,500	Second Mortgage-No Ceiling
Washington	2,500	Industrial Loan Law-15% of Capital and Surplus
West Virginia	1,600	Second Mortgage Law-No Ceiling
Wisconsin	None	Discount Loan Law-No Ceiling
Wyoming, UCCC	25,000	Mortgage Loans-No Ceiling

V. INTEREST CEILING: APPRAISAL

Some observers suggest that consumer credit markets are not competitive and that consumers in the market segment served by small loan licensees fail to shop for the lowest interest rate. This, they say, explains why, in recent years, most small loan companies have charged interest at the maximum rates. While some high risk consumers, who recognize that they have few credit alternatives are more sensitive to size of monthly payments than to interest rate, they still can compare rates offered by the various licensees serving their area. Since enactment of the Truth-in-Lending Act over a decade ago, even the high-risk customer is aware that terms may vary among creditors.

Neither can it be demonstrated that consumer credit markets are not competitive. Though market segmentation, which is due, in part, to regulation, tends to insulate, somewhat, one type of lender (i.e., small loan companies) from direct competition with another type (i.e., banks or credit unions), in a market characterized by the absence of entry barriers, existing licensees could not set unreasonably high rates for long without encouraging new licensees to enter the market. Experience in other states has borne out this belief. In its 1972 report, the National Commission on Consumer Finance found that in many states rates charged by small loan companies were below the statutory interest rate ceilings. In a significant number of cases, the rate was lower than 90% of the statutory ceiling. (Consumer Credit in the U.S.: Report of the National Commission on Consumer Finance, pp. 99, 100)

As mentioned previously, the most reasonable explanation for the charging of interest rates at legal ceilings is that the market rate (the rate which would prevail in a free market) is at or above the ceiling rate. With a restrictive rate ceiling, small loan companies would be barred from adjusting their rates upward to offset higher credit risks (i.e., increased bankruptcy losses), increases in the cost of funds (i.e., high market rates) or increases in operating costs. Licensed lenders would be forced to make nonprice adjustments such as lowering their risk exposure (to reduce bad debt losses and collection costs). The effect of this would be a reduction in the supply of credit at existing rates, since licensees would be unwilling to serve the higher credit risks. (As mentioned previously, about 75% of small loan licensees have ceased granting new credit.) It is doubtful that the decline in the number and dollar amount of accounts is due solely to the rise of credit unions and other competitors. Licensees in Michigan have greatly curtailed the supply of credit.

The most serious possible shortcoming of a policy which is ostensibly designed to protect consumers from being overcharged or becoming overextended is that the denial of credit to a needy, marginal risk borrower does not eliminate the consumer's demand for credit. The implications of this are far-reaching for those consumers who have marginal credit ratings. A significant number of those denied credit from legal sources may turn to illegal lenders where the interest rates charged in some cases may exceed 1,000% per year. (Consumer Credit in the U.S.: Report of the National Commission on Consumer Finance, pp. 104-105)

Another undesirable by-product of restrictive interest rate ceilings is that borrowers denied cash credit from legal sources might obtain financing from retailers where an excessive finance charge could be buried in the price of the goods purchased. In the Report of the National Commission on Consumer Finance, the Commission cited a study conducted by the FTC in 1968 regarding credit prices. "Although the average of APR's charged by low income retailers was about 4 percentage points higher than the rate of general market retailers to finance a sewing machine with a common wholesale price of $100, the average cash retail price of the low income retailer was $297 compared with average cash prices of only $197 at appliance stores and $174 at department stores". The Commission concluded that the best way of preventing these abuses, "is to introduce more competitive alternatives especially in the form of cash credit" in such markets. This position was based on the assumption that much of the market power of inner city retailers to raise the prices of financed items derived from the unavailability of direct cash credit. (Consumer Credit in the U.S.: Report of the National Commission on Consumer Finance, p. 105)

Based on the above discussion, it appears that more information on the demographic characteristics of small loan borrowers is needed. To what extent does the "typical" customer of small loan companies lack alternatives? If a significant number of small loan borrowers have no alternative legal source of funds to the small loan licensee, then restrictive interest and loan ceilings may have undesirable consequences. On the other hand, if most borrowers from small loan companies do have alternative sources of credit, then one must assume that there are important non-rate factors which are responsible for their choice of this relatively costly source of credit.

Interest Rates in Other States

Due to the complexity of interest rate ceilings on small loans in the different states, it is difficult to make an accurate comparison of rates. However, data supplied by the National Consumer Finance Association show that the rate ceilings in 32 states, as of November, 1981, were higher on most sizes of small loans than the Michigan ceiling. These states are: Alabama, Alaska, Arizona, Colorado, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Lousiana, Maryland, Minnesota, Mississippi, Montana, Nevada, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Oregon, Rhode Island, South Carolina, Texas, Utah, Virginia, West Virginia, and Wyoming. Six of these states (Delaware, Illinois, Nevada, New Mexico, New York and Oregon) have no ceilings on interest rates on small loans. In the remaining 16 states included in the November 1981 summary, rate ceilings were neither clearly higher nor clearly lower than Michigan's ceiling in most loan size categories. (Appendix A contains a detailed schedule of maximum legal interest rates in forty nine of the fifty states in November 1981. These rates are not expressed in terms of annual percentage rates and thus are difficult to compare. Additionally, a number of states have increased their interest rate ceilings on small loans since November, 1981.)

VI. BORROWER PROFILE

Table 8 shows trends in income, age and occupation of borrowers from finance companies from 1970 to 1979. In 1979, the median annual family income nationwide was $16,009. (Current Population Reports, June 1980, Money Income of Families and Persons in the United States, page 2, Table A) Yet 47.7% of finance company loans were made to borrowers earning $12,000 per year or less. According to Table 9, loans to borrowers with incomes of $15,000 or less accounted for 65.7% of the number and 49.5% of the amount of loans made by finance companies in 1979. The National Consumer Finance Association estimates that the households whose incomes fell below $15,000 per annum amounted to only 45.4% of all households in the U. S. and accounted for just 18.1% of total household incomes.

TABLE 8

Percent Distribution of the Number of Loans Made by Borrower Characteristics, Selected Years, 1970-1979**

By Monthly Income of Borrower	1970	1975	1977	1978	1979
$500 or less	38.4	12.2	13.0	4.9	9.3
$500.01 to $750	32.7	28.9	20.3	17.3	17.6
$750.01 to $1,000	17.7	22.0	18.4	18.7	20.8
$1000.01 to $1,250	11.2*	36.9*	48.3*	59.1*	18.0
$1,250.01 to $2,000	na	na	na	na	26.3
Over $2,000	na	na	na	na	8.0
Total	100.0	100.0	100.0	100.0	100.0
By Age of Borrower					
Less than 25 years	14.1	18.0	17.2	18.8	29.9
25 to 34 years	31.3	28.8	34.2	37.6	31.1
35 to 44 years	24.6	23.5	21.4	18.3	18.9
45 to 54 years	19.6	23.1	16.6	15.5	12.6
55 to 64 years	9.3	6.0	9.0	8.3	5.8
65 years and over	1.1	0.6	1.6	1.5	1.7
Total	100.0	100.0	100.0	100.0	100.0
By Occupation of Borrower					
Proprietors, managers and office workers, excluding farm	5.5	na	na	6.2	na
Craftsmen, foremen and kindred workers	42.8	na	na	40.4	na
Operatives, laborers and kindred workers, including farm and mine	19.6	na	na	21.8	na
Clerical and kindred workers	6.1	na	na	7.8	na
Sales persons	2.8	na	na	2.5	na
School teachers	1.3	na	na	1.3	na
Professional and semi-professional workers, excluding teachers	2.0	na	na	1.7	na
Service workers, including government civilian and military personnel	14.2	na	na	13.8	na
Unemployed, occupations not reported and miscellaneous	5.7	na	na	4.5	na
Total	100.0	na	na	100.0	na

Note: Parts may not add to total due to rounding.
na: Not available
* Over $1,000

**National Consumer Finance Association, Finance Facts Yearbook, 1981

TABLE 9

Percent Distribution of Borrowers From Finance Companies and All Households, By Income and Age Groups, 1979***

	Borrowers from Finance Companies Percent Of:		All Households Percent Of:	
	Number of Loans	Amount of Loans	Number of Households	Amount Household Income*
By Annual Income				
$6,000 or less.	9.3	5.1	13.1**	1.7**
$6,001 to $9,000	17.6	11.5	16.4**	6.3**
$9,001 to $15,000	38.8	32.9	15.9**	10.1**
$15,001 to $24,000	26.3	34.1	26.4**	26.7**
Over $24,000	8.0	16.4	28.1**	55.2**
Total	100.0	100.0	100.0	100.0
By Age				
Less than 25 years	29.9	20.9	8.0	5.5
25 to 34 years	31.1	31.4	22.6	22.6
35 to 44 years	18.9	23.9	17.6	22.1
45 to 54 years	12.6	15.8	15.9	21.1
55 to 64 years	5.8	6.9	15.4	17.1
65 years and over	1.7	1.1	20.4	11.6
Total	100.0	100.0	100.0	100.0
Number in millions	14.8	-	79.1	-
Amount in billions of dollars	-	$ 29.9	-	$ 1,552.7

Note: Parts may not add to totals due to rounding.

* Amount of income by income levels is NCFA estimate.

** Under $5,000 in income in the first group, $5,000 to $9,999 in the second group, $10,000 to $14,999 in the third group, $15,000 to $24,999 in the fourth group, and $25,000 or more in the fifth group.

*** National Consumer Finance Association, Finance Facts Yearbook, 1981

The vast majority (79.9%) of borrowers are under 45 years of age. Even more significant, since 1970 the percentage of borrowers under 25 years of age has more than doubled to nearly 30%. Yet households whose members are younger than 25 account for only 8% of all households in this country and for only 5.5 % of total household income in the United States. It is clear that this youthful group relies heavily on credit from finance companies.

On the other hand, only 1.7% of finance company loans in 1979 were made to borrowers over 65 years of age. People of 65 and older constitute a large part of our nation's population (about 10.4% of all households) and their households account for nearly 12% of all household income. This group appears to be much less dependent on finance company credit than the population under 25 years of age. This is not surprising since people over 65 generally are not heavy borrowers.

Nationwide, in 1979 over 40% of finance company loans were made to people who were craftsmen, or foremen, or performed similar duties. Operatives, laborers, and farm and mine workers received 21.8% of finance company loans. Since much of Michigan's population is employed in manufacturing and agriculture, it is possible that an even higher percentage of credit extended by Michigan finance companies goes to borrowers employed in those areas.

Tables 8 and 9 provide a fairly clear picture of the typical finance company borrower--a young person, probably employed in manufacturing, whose annual income is likely to be below the national median.

VII. CONCLUSIONS AND RECOMMENDATIONS

The Bureau recommends that regulatory loan licensees be permitted to charge any rate of interest. The Bureau has taken this position with respect to the interest rate ceilings for all regulated lenders. It is obvious that the current interest rate ceiling is woefully inadequate. The long-term decline in the number of licensees constitutes the best evidence that interest rate relief is long overdue. The small loan industries in other states which permit more favorable loan rates are not being liquidated. The rates which licensees pay for borrowed funds are not limited by ceilings but rather reflect the prevailing conditions in the money market. When one considers that some licensees, mainly independents, borrow at rates as high as the prime rate plus 4%, it points to the conclusion that the rates allowed under the Regulatory Loan Act are highly restrictive. Some of the opponents of interest rate deregulation argue that the long-term decline in the number of licensees reflects a reduction in the demand for what is a relatively high cost source of funds. There is, however, substantial anecdotal evidence suggesting that, in relation to the demand for other types of consumer credit, the demand for small loans remains strong. The extremely high denial rates reported by some licensees suggests that many consumers regard the credit extended by small loan companies as reasonably priced. Some would argue that the persistence of relatively strong demand (during much of the recent period of high interest rates, some licensees have reported denial rates on loan applications in excess of 90%) instead shows that many consumers have few alternatives to the small loan licensee in the legal cash credit market.

The Bureau recommends that the current $3,000 loan ceiling be eliminated. In view of the inflation experienced in recent years it is illusory to say that Michigan has a fixed loan ceiling of $3,000. During the period from March 1979 to April 1982, consumer prices, as measured by the Consumer Price Index (CPI), increased by 36.0% This means that to maintain the original purchasing power of $3,000 in 1979, would require that the loan ceiling be increased to $4,080 today and adjusted upward thereafter in line with increases in the CPI. There are no sound economic arguments for setting a fixed dollar loan ceiling. This is especially true since this $3,000 loan ceiling was inadequate from its inception. By failing to give full recognition to the eroding effects of inflation, the Legislature established a loan ceiling which was destined to decline steadily in real terms. The restrictive loan ceiling has reduced the ability of consumers to obtain modest amounts of credit. Further, over time, even when economic conditions were more favorable, this has relegated the small loan industry to a steadily declining segment of the consumer credit market. Consumers in need of amounts of credit in excess of $3,000 cannot obtain it from a single small loan licensee, but must try to get loans totalling the amount needed from different licensees. This increases the consumer's credit costs substantially. (Further compounding this problem is the restrictive interest rate ceiling which means that small loan licensees can serve only the low risk part of a segment of the market already diminished by the steadily eroding loan ceiling.)

It is well known that, for many consumers, the small loan company represents one of the few, if not the only legal source of cash credit available. It is axiomatic that the denial of a consumer's credit application does not eliminate his/her demand for credit. Thus, the increasing inability of small loan licensees to satisfy the credit demand of many consumers likely has had consequences which were never intended by the proponents of the current legal restrictions. Some consumers may turn to certain retailers which bury part of the finance charge in higher purchase prices. In some instances, consumers denied credit in the legal market simply have been unable to obtain credit and to purchase the good or service that was to be financed. In other cases, consumers denied credit in the legal market likely have turned to illegal lenders who charge rates that are many times higher than the rates which small loan licensees are permitted to charge and who do not observe the legal requirements of the Collection Practices Act. Unfortunately, it is difficult to document the extent of illegal loan sharking, since such lenders are not examined by a government agency nor do they file annual reports with the state. An objective appraisal of the facts forces one to conclude that at least some of the consumers who are denied credit in the legal market turn to illegal lenders. Because the problem is an unseen one, it is abstract in the minds of many and has been conveniently ignored.

There is little question that the biggest beneficiaries of interest rate ceilings are illegal lenders who are guaranteed a segment of the consumer credit market when the ceilings become binding price controls. Proponents of restrictive ceilings frequently challenge the contention that illegal lenders constitute a significant problem, saying that they are unaware of any documented cases. This absence of reported cases of loan sharking is hardly surprising. Not only do illegal lenders not file reports of their activities, but "Furthermore, lowered rate ceilings for the use of cash credit increase the likelihood of unconscionable collection tactics because the high risk consumer must turn to illegal lenders for the cash credit he needs. Such a consumer does not report vicious collection procedures for fear for his life and property and that of his family. If in the cash loan field the aim is to protect consumers from heavy-handed collection efforts, a lowering of the rate ceiling is counter-productive for less affluent, high risk consumers." (Source: Consumer Credit in the United States: Report of the National Commission on Consumer Finance, December 1972, p. 101.)

The restrictive loan ceiling is likely to have another effect which could not have been intended by those who oppose increasing or eliminating the ceiling. A few small loan companies have applied for licenses under the recently enacted Secondary Mortgage Act. This reflects at least two economic factors: that the restrictive interest and loan ceilings allowed to small loan licensees are inadequate, and that real estate, even a second lien, constitutes stronger security than the forms of security taken by small loan licensees. (It must be mentioned that, to date, few, if any, loans have been made by any licensee under the Secondary Mortgage Act because of the inadequate, low interest rate ceiling. It is hoped that the Legislature will address this issue in the near future.) Many borrowers applying for more than $3,000 in credit from small loan licensees would be forced to offer a second mortgage, with the attendant closing costs, in order to qualify for a loan. Thus, once again, the efforts of the opponents of higher rate and loan ceilings to protect consumers may produce an unintended result. Further, many renters, with no home to offer as security for a loan, will be unable to obtain credit from a secondary mortgage lender.

APPENDIX A

INTEREST RATE CEILINGS ON REGULATORY LOANS IN OTHER STATES

STATE	MAXIMUM RATE
Alabama	3% to $200, 2% to $749. On loans of $75 or less $1 for each $5 loaned. Consumer Credit Act: 15% per year add-on to $750, 10% to $2,000, and 8% over $2,000; or 18% per year on unpaid balances. Revolving Credit: 1 3/4% - 1 1/2% @ $750 (after 6/1/83, 1 1/2%). Interest Surcharge: 2% (max. $20) for all loans to 6/1/83.
Alaska	3% to $500, 2% to $1,000, 1% over $1,000; or APR equivalent. Over $5,000, 1 1/2% or 8% over FRB discount rate. On loans of $50 or less, 5%. Revolving credit permitted.
Arizona	3% to $300, 2% to $600, 1 1/2% to $1,000. Over $1,000: 2 1/2% to $300, 2% to $1,000, 1 1/2% to $1,500, 1% to $10,000; or 1.625%. To $1,500, 1% document preparation fee.
California	Personal Property Broker: 2 1/2% to $225, 2% to $900, 1 1/2% to $1,650, 1%, APR equivalent; or 1.6% to $10,000. Revolving credit permitted. No max. above $10,000. Companion "Small Loan Law" is inoperative.
Colorado	UCCC: 36% per year to $630, 21% to $2,100, 15% to $25,000; or 21% per year. (min $15, $25 @ $500) Revolving credit: 21% per year (except 18% for purchases unless "free period" provided).
Connecticut	Add-on rate: $17 a year per $100 to $600 and $11 on remainder for secured loans (but not auto or household goods) to $1,800 or unsecured loans to $5,000; $11 on entire amount if secured by real estate (over $1,800) or personal property (but not household goods.) 12% per year on unpaid balances after maximum maturity. Revolving credit: 18% per year. Real estate loans: No maximum over $5,000, except 24% APR for small loan licensees' affiliates, and licensing required.
Delaware	Discount Act: no limit.
District of Columbia	Small Loan Law is inoperative.
Florida	30% per year to $500, 24% to $1,000, 18% to $2,500; 18% over $2,500. 10% per year one year after maturity.
Georgia	Industrial Loan Act: 10% a year discount for 18 months, add-on for longer maturities; fee of 8% of first $600 and 4% of excess plus $2 per month; 5% for default of 5 days.

STATE	MAXIMUM RATE
Hawaii	3 1/2% to $100, 2 1/2% to $300. Industrial Loan Act: 14% per year discount for first 18 months, 10.5% for next 12 months, 7% for next 12 months, 4% for remaining months to 48 months; transfer of equity fee; or 24% per year on unpaid balances. (Temporary rate increase to 7/1/85.) Revolving credit: 24% per year.
Idaho	UCCC 36% per year to $660, 24% to $2,200, 18% to $55,000; or 21% per year. Revolving credit: 21% per year.
Illinois	Consumer Finance Act: no limit. Consumer Installment Loan Act: no limit (Applies to banks.)
Indiana	UCCC: 36% per year to $540, 21% to $1,800, 15% to $45,000; or 21% per year. Revolving credit; 13% or graduated rates.
Iowa	3% to $500, 2% to $1,200, 1 1/2% to $2,000, (Rate set by State Banking Board.) Industrial Loan Act: 10% per year discount (after 7/1/83, 9%) plus fee of $1 per $50 ($40 max.); max. 24% APR on discount (Sec. 535.6)
Kansas	36% per year to $420, 21% to $1,400, 14.45% to $25,000; or 18% per year. Revolving loans permitted. (min. $5 - 7.50 @ $75.
Kentucky	3% to $600. 2% to $1,500, 1 1/2% to $2,000. Industrial Loan Act: 8% per year add-on or discount plus fee of $1 per $50 to $2,000; 5% up to $5 per installment for default of 10 days. (See A. G. Op. No. 72-274 re rates.)
Louisiana	36% per year to $1,400, 27% to $4,000, 24% to $7,000, 21% on any remainder. Revolving credit permitted. (min. $15 - $25 @ $200) Rate limited to 18% per year 12 months after maturity.
Maine	18% per year. (min. $5, $7.50, $25 @ $75 - 250) Revolving credit permitted. Unique restrictions make higher rates generally inoperative (30% per year to $540, 21% to $1,800, 15% to $45,000). Most licenses have ceased business.
Maryland	To $2,000: 2 3/4% to $500, 2% to $700, and 1 1/4% to $2,000. From $2,000 to $3,500: 1 3/4%. From $3,500 to $5,000: 1 1/2%. Over $5,000: 1.35%.
Massachusetts	23% per year plus $20 annual fee. Rate Fixing Board. (6% a year 12 months after maturity.) General Interest Law: 20% per year over $6,000 except for second home mortgage loans.

STATE	MAXIMUM RATE
Michigan	31% per year to $500, 13% to $3,000, or 18% on entire balance.
Minnesota	Regulated Loan Act: 33% per year to $350, 19% over $350; or 21.75% on entire balance.
Mississippi	36% per year to $800, 33% to $1,800, 24% to $4,500, 12% over $4,500. Dollar amounts subject to changes based on FRB discount rate to 6/30/82.
Missouri	2.218% ($15 per $100 a year add-on) to $800, 1.25% to $2,500, 10% per year on balances over $2,500, plus fee of 5% (max. $15).
Montana	Add-on rate: $20 a year per $100 to $500, $16 to $1,000 and $12 to $7,500. 2% per month on unpaid balances over $7,500. On loans of $90 or less $1 for each $5. Revolving credit: 24% per year.
Nebraska	24% to $1,000, 18% to $5,000, 16% to $7,000. Revolving credit permitted.
Nevada	No limit.
New Hampshire	2% to $600, 1 1/2% to $1,500, no limit on larger loans. (Rate drops to 12% a year 3 months after maturity.)
New Jersey	30% per year. Revolving credit permitted.
New Mexico	No limit (after 7/1/83, 3% to $150, 2 1/2% to $300, 1 1/2% to $1,000, 1 1/4% to $2,500). Rate drops to 10% a year one year after maturity, entry of judgment, 90 days after a bankruptcy adjudication followed by discharge or 90 days after borrower's death. Installment Loan Law: No limit (after 7/1/83, 8.75% per year add-on; min. $2 per month or $10; $15 fee).
New York	No limit (after 6/30/83, 2 1/2% to $100, 2% to $300, 1 1/2% to $900, 1 1/4% to $2,500) Licensed lender second mortgage loans (by rule): No limit until 6/30/83.
North Carolina	3% to $600, 1 1/4% to $3,000 (after 7/1/83, 3% to $300, 1 1/2% to $3,000). (6% per year after maturity.) Optional rate: 16% per year "effective rate" or 6% over 6-mo. U.S. T-bill rate to 7/1/83 ($10 per loan or $1 per payment min.) on loans to $5,000. "Motor vehicle" licensees: Add-on: $15 a year per $100 to $500, $11 to $1,000, $9 to $1,500, or 16% a year simple interest between $1,500 and $5,000.

STATE	MAXIMUM RATE
North Dakota	2 1/2% to $250, 2% to $500, 1 3/4% to $750, 1 1/2% to $1,000. Consumer Finance Act: no limit over $1,000. Revolving credit permitted.
Ohio	28% per year to $1,000, 22% on remainder; or equivalent APR. Revolving credit permitted. Second Mortgage Act: 21% per year. Revolving credit permitted.
Oklahoma	UCCC: 30% a year to $540, 21% to $1,800, 15% to $45,000; or 21% per year. Special rates for loans to $100. Revolving credit permitted.
Oregon	No limit. Revolving credit permitted.
Pennsylvania	To $5,000: 9 1/2% per year discount for 36 months, 6% for remaining period, plus max. fee of $15 ($1 for each $50 or fraction); 1 1/2% per month for default or deferment, 2% per month (no pre-comp.) for revolving and installment loans to $5,000. See rules re installment loans over $5,000.
Puerto Rico	20¢ a year per $1 to $300, 7¢ to $600 add-on.
Rhode Island	Rate on entire balance: 3% on loans to $300, 2 1/2% on loans between $300 and $800, and 2% on larger loans. General Interest Law: 21% per year (interest and expenses).
South Carolina	Supervised Lenders: 36% per year to $390, 21% to $1,300, 15% to $32,500; or 18% on entire balance. Revolving lending permitted (revolving sale rates permitted for lender credit cards). Dollar adjustments until 7/1/84.
South Dakota	30% per year to $500, 24% to $1,200, 18% to $2,000, 12% to $2,500. Over $2,500, 19.5% per year on entire balance. $2 min. in certain cases. (10% per year 6 mos. after maturity). Revolving credit permitted.
Tennessee	Industrial Loan Act: 7 1/2% per year discount (max. 18% per year on unpaid balances) plus fee of 4% or $2 to $20, 50¢ per $5 to $75, and $7.50 for larger loans, and monthly fee of $1.50 to $300 and $1 for larger loans.
Texas	Add-on rates: $18 a year per $100 to $750, $8 to $6,250, or formula rate. Special rates for loans to $250. Revolving credit permitted. Consumer Credit Code. Ch. 4: $8 per year add-on or formula rate. Revolving credit permitted.

STATE	MAXIMUM RATE
Utah	UCCC: 36% per year to $660, 21% to $2,200, 15% to $55,000; or 21%* per year. Revolving credit permitted. *18% 60 days after end of 1982 legislative session.
Vermont	2% to $1,000, 1% to $3,000; or 1 1/2%. Second mortgages (part of usury law): 18% per year (only over $3,000 for licensees).
Virginia	3% to $500, 2 1/4% to $1,500, 1 1/2% to $2,500; or add-on rate, $21 a year per $100 to $500, $17 to $1,500, $13 to $2,500, plus 2% fee. (rate drops to 6% a year 6 months after maturity or after judgment, or 90 days after borrower's death or bankruptcy.) Rates and ceiling set by Commission.
Washington	2 1/2% to $500, 1 1/2% to $1,000, 1% to $2,500. Industrial Loan Act: 10% per year discount plus 2% fee ($2 min. fee) and 50¢ per month. Real estate loans: 25% APR over 2 years.
West Virginia	36% per year to $500, 24% to $1,501; 18% to $1,600, until 7/1/82. Revolving credit permitted (min. 50¢/mo.).
Wisconsin	Discount Loan Law, Sec. 138.09: 23% per year simple interest under $3,000; 21% on entire balance if $3,000 or more; or 6% over greater of 6-month or 2-year Treasury rates. No limit from 11/1/84 to 10/31/87 for rates or rebates. Revolving credit permitted.
Wyoming	UCCC: 36% per year to $300, 21% to $1,000, 15% to $25,000; or 21% per year. Revolving credit: 21% per year. No limit over $25,000.

(Source: National Consumer Finance Association, Summary of Consumer Credit Laws and Rates, November 1981)

RECEIVED APR 12 '83

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

James M. Wooten
President
(202) 861-6500

April 11, 1983

The Honorable Jake Garn
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The Mortgage Bankers Association of America (MBA) supports enactment of S 730, the "Credit Deregulation and Availability Act of 1982," but suggests that two amendments be added. The amendments would extend the Federal preemption of State usury laws to second mortgages on residential real property and would clarify that the restrictions on the exercise of due-on-sale clauses imposed by the Garn-St Germain Depository Institutions Act of 1982 (PL 97-320) were intended to apply only to residential one-to-four family residential real estate and not commercial real estate.

The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate financing portfolios.

The credit markets of the United States are increasingly losing their local and regional character. The efficiencies of nationwide credit markets have permitted consumers and business to satisfy their financing needs timely and at lesser real cost, in the long range, than smaller, isolated markets could. State usury laws, perhaps once useful in protecting borrowers from situations where there was but one source or a limited few sources of credit in a particular area, have become anachronistic impediments to the flow of funds nationwide. As the Congress recognized in 1980, when passing Title V of the Depository Intitutions Deregulations and Monetary Control Act of 1980 (PL 96-221), the Federal interest in encouraging efficient business and consumer credit supports a sweeping away of anachronistic usury laws. That Act also recognized that a few states might wish to review and revise their laws and provided a time for those states to do so. The time is expiring, and the Federal clearing-away of the various usury laws has proven beneficial nationally, and should now be made final.

PREEMPTION OF USURY FOR SECOND MORTGAGES

MBA urges the Subcommittee to provide a Federal usury preemption for mortgages secured by a second lien on residential real estate, in the same fashion as Congress enacted the Federal usury preemption, which now protects first lien mortgages from restrictive state usury laws.

The demand for second lien mortgage loans has increased dramatically in recent years. From a market share of 5 percent in the mid-1970s, second lien mortgages had expanded to 40 percent of the market in 1981 by a recent estimate in U.S. Housing Markets, a publication of Advance Mortgage Corporation, Southfield, Michigan. (See: "Seconds, A Snowballing Market," Walter P. Blass, Mortgage Banking, February, 1983, pp. 25-30.) The study estimates that when activity for 1982 is fully reported, second lien activity by all types of lenders will have sustained the volume of approximately $19 billion originated in 1980. MBA's survey of mortgage banking companies concluded that mortgage bankers originated $735 million in second mortgage loans in 1981, the last year for which data is available, compared to $244 million in 1979.

The rapid increase in second lien mortgage lending comes from increased use of such mortgages to facilitate first lien transactions and from a desire of homeowners to borrow against their equity without paying off the existing first mortgage. More and more buyers are forced to use second mortgages in purchasing a home because the appreciation of house prices has exceeded the family's ability to save for a substantial down payment even though the buyers may have sufficient income to meet both first and second mortgages. In situations where existing first liens carry high prepayment penalities or carry interest rates much lower than current rates on new loans, second mortgages provide a means by which the homebuyers can "refinance" his mortgage investment without disturbing the first lien.

Second mortgages are also used to provide rehabilitation and repair of existing residential real properties. This is especially true in multi-family housing projects. More and more, it has become clear that as housing becomes more expensive, people are moving less, buying fewer "new" homes, and instead, are repairing what they own. A second mortgage usury preemption would facilitate such a national rehabilitation effort.

This is especially important for the elderly and retired persons who have lived in their home for decades and whose first mortgage is substantially paid down, but who need funds to rehabilitate their life long investment.

Second mortgages are also used extensively in large multi-family housing project developments where several lenders are involved. A second mortgage preemption would also facilitate new multi-family rental housing, which has, as a percentage of new building, been decreasing rapidly over the last decade.

Responding to and encouraging the increased market demand for financing based on home equity that does not disturb an existing, favorable-rate first lien mortgage, the Federal National Mortgage Association (FNMA) entered the secondary market for second lien mortgages in late 1981. When FNMA began to make commitments to purchase second lien mortgages at yields only 1/4 percentage point higher than yields it required on first lien mortgages, a new depth was brought to the secondary market for second mortgages. Not only is FNMA's activity helpful to mortgage originators who sell to FNMA, but the presence of FNMA in the market has provided reassurance for other lenders to enter the second lien mortgage business.

In enacting Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221), which preempted state usury laws for first lien mortgages, Congress recognized that anachronistic state legal limits on interest rates and discount points were impeding the operation of the nationwide mortgage market, and preventing the equal flow of mortgage credit to the Nation's citizens. Concerned lest the rights of the states be unnecessarily preempted, Congress allowed each state until April 1, 1983 to act to re-impose usury ceilings. To date, only 14 states have chosen to act to reassert jurisdiction over interest rates on first lien mortgages, and none of them has acted in a manner significantly detrimental to the market.

The impediments which interfered with the nationwide market for first mortgage financing continue to interfere with second mortgage borrowing. Eighteen states specifically limit second mortgage rates; the remaining states have a variety of laws restricting borrowing charges. As with first mortgages, such laws should be set aside, with, of course, the authority reserved to the states to reconsider imposing usury limits if any wishes to do so.

LIMITATIONS ON THE ENFORCEMENT OF DUE-ON-SALE CLAUSES

Institutional lenders active in the business of financing income-producing real estate have expressed concern that Section 341(d) of the Garn-St Germain Depository Institutions Act of 1982 (PL 97-320), read literally, could be interpreted as prohibiting the enforcement of any and all due-on-sale clauses, even those in mortgages secured by commercial property. MBA urges that the section be amended to clarify that it was not intended to extend to income property loans, by inserting "with respect to owner-occupied one-to-four dwelling unit residential real property," between "due-on-sale" and "upon."

The restrictions of the section were not intended to apply to business property. As Senate Report No. 97-536, reporting the Act, explains, "the intent of this section is to provide protections for consumers by prohibiting the enforcement of due-on-sale clauses where such enforcement would be inequitable" (page 25).

The Act provides the Federal Home Loan Bank Board with authority to interpret the section, including the limitations on enforcement of due-on-sale clauses. The Board has interpreted Section 341(d) as applying only to residential, not commercial property. However, in the past Courts have refused to follow an interpretive regulation which appears contrary to and without support in the literal [illegible] of the statute being interpreted.

To restore the certainty and confidence so important to the real estate lending market, especially the large balance financing needed for commercial development, the limitations on the enforcement of due-on-sale clauses [illegible] Section 341(d) of the Act should be clarified as not applying to commercial income producing property.

We appreciate this opportunity to present our views, and would be happy to furnish any additional information if you should desire.

Sincerely,

James M. Wooten

James M. Wooten
President

JMW/abi

TESTIMONY

From

William R. Garpow
Vice President, Public Affairs

Recreation Vehicle Industry Association
14650 Lee Road,
P.O. Box 204
Chantilly, Virginia 22021
(703) 968-7722

Before the United States Senate
Committee on Banking, Housing and Urban Affairs
Washington, D.C.

On Senate Bill 730
Credit Deregulation and Availability Act of 1983

Hearing Held April 12, 1983

RVIA TESTIMONY

Senate Bill 730

April 12, 1983

Senator Garn and members of the Senate Committee on Banking, Housing and Urban Affairs. We appreciate this opportunity to present our thoughts to your committee in support of this effort to curb unreasonable state usury laws and add our voice to what we hope will be a decision by your committee to support this needed legislation.

The Recreation Vehicle Industry Association is a national trade association which represents the recreation vehicle manufacturers and their component suppliers who provide family camping vehicles to citizens of the United States. Nearly 95% of all recreation vehicles produced in this country are built by members of our association. With this in mind, our testimony today can be viewed as representing the collective voice of this industry.

This is our industry's second opportunity to discuss this subject before the Senate. Previously we testified to the Senate Subcommittee on Financial Institutions on July 9, 1981, on the "Credit Deregulation and Availability Act of 1981" and for the record, we are again submitting that testimony.

Essentially, the problem of archaic levels of usury limits with adjustments by a few states still exists. However, the trigger mechanism of high interest rates no longer poses an immediate problem. Still, we believe that the financial cycle will eventually return us to the crisis which existed just a few short months ago.

We congratulate this committee for its far-sightedness in attempting to resolve a potentially harmful situation before it becomes a reality.

It is our continuing opinion that the basic law of supply-and-demand is the best of all regulators with any commodity, including money. We also support the premise that any unnecessary controls or rate ceilings developed through the political process, to "legislate fairness" serve only to artificially unbalance the system. When invoked, usury rates only embargo the available resources from meeting the needs of potential customers and denying them the products they require.

It is untimely that state usury laws are usually invoked when the unemployment levels are on the rise. Usury laws will, therefore, tend to heighten that unemployment by further slowing the marketing of goods and service in an already troubled economy. This situation only places a penalty on the very people the usury laws were enacted to protect.

We appreciate this opportunity to testify for the record and sincerely hope this initiative can become law.

STATEMENT BY

GORDON E. (MIKE) GILBERT

Senior Vice President

and

Member of the Executive Committee

of

Coachmen Industries, Inc.

Representing

RECREATION VEHICLE INDUSTRY ASSOCIATION

14650 Lee Road
P.O. Box 204
Chantilly, Virginia
(703) 968-7722

Before the

United States Senate

Subcommittee on Financial Institutions

Washington, D.C.

on

Senate Bill 1406

Credit Deregulation and Availability Act of 1981

July 9, 1981

MR. CHAIRMAN:

MY NAME IS MIKE GILBERT, AND I AM SENIOR VICE PRESIDENT AND A MEMBER OF THE EXECUTIVE COMMITTEE OF COACHMEN INDUSTRIES, MIDDLEBURY, INDIANA.

COACHMEN MANUFACTURES RECREATIONAL VEHICLES, BOATS, MOBILE HOMES AND ACCESSORIES FOR THESE PRODUCTS. OUR COMPANY IS A VERY ACTIVE MEMBER OF OUR TRADE ASSOCIATION, THE RECREATION VEHICLE INDUSTRY ASSOCIATION, AND I AM ON THE RVIA'S FINANCE COMMITTEE.

ON BEHALF OF MY COMPANY AND THE RECREATION VEHICLE INDUSTRY ASSOCIATION, I WANT TO THANK YOU FOR THE OPPORTUNITY TO COMMENT ON SENATE BILL 1406 AND SENATE BILL 963.

IN ADDITION TO THE RECREATION VEHICLE INDUSTRY, THERE ARE OTHER ORGANIZATIONS IN THE RECREATIONAL AREA AFFECTED BY THIS LEGISLATION. WE ARE ALL MEMBERS OF THE AMERICAN RECREATION COALITION, A GROUP OF TRADE ASSOCIATIONS AND USER GROUPS DEDICATED TO THE PROTECTION AND ENHANCEMENT OF EVERY CITIZEN'S RIGHT TO PURSUE HEALTH AND HAPPINESS THROUGH LEISURE-TIME ACTIVITIES.

THE AMERICAN SKI FEDERATION, THE INTERNATIONAL SNOWMOBILE INDUSTRY ASSOCIATION, THE MOTORCYCLE INDUSTRY COUNCIL, THE NATIONAL MARINE MANUFACTURERS ASSOCIATION, THE NATIONAL SPA AND POOL INSTITUTE, AND THE RECREATION VEHICLE DEALERS ASSOCIATION ARE AMONG THE ORGANIZATIONS THAT HAVE EXPRESSED A HIGH INTEREST IN THIS LEGISLATION AND HAVE BEEN HELPFUL IN FOCUSING ATTENTION ON THE ISSUE BEFORE US TODAY.

A POLICY POSITION STATEMENT BY THE AMERICAN RECREATION COALITION IS ATTACHED TO MY COMMENTS AND I ASK THAT IT BE SUBMITTED FOR THE RECORD.

THE MEMBERS OF THE COALITION, MY COMPANY, AND THE RECREATION VEHICLE INDUSTRY ASSOCIATION WISH TO RECOGNIZE AND APPLAUD THE EFFORTS OF THE SENATORS FROM ARKANSAS, SENATOR BUMPERS AND SENATOR PRYOR, WHOSE MEASURE, S 963, IS ALSO BEING CONSIDERED HERE TODAY. THEIR EFFORTS ARE APPRECIATED IN VIEW OF THE UNIQUE STATUS OF THEIR STATE REGARDING AVAILABILITY OF CREDIT, BUT THE PROBLEM EXTENDS TO MANY OTHER STATES, AND WE FEEL THAT S 1406 WILL ADDRESS THEIR PARTICULAR PROBLEM AND ALSO ALLEVIATE THE PROBLEM OF CREDIT AVAILABILITY ON A NATIONAL SCALE.

MY MAIN PURPOSE HERE TODAY IS TO LET YOU KNOW HOW THE NON-AVAILABILITY OF CONSUMER CREDIT AFFECTS COACHMEN

INDUSTRIES AND ITS DEALERS, AND OTHER MANUFACTURER AND SUPPLIER MEMBERS OF THE RECREATION VEHICLE INDUSTRY ASSOCIATION. TO USE A COMIC STRIP ANALOGY, OUR INDUSTRY HAS BEEN HIT WITH A REAL "TRIPLE WHAMMY." THE FIRST WHAMMY WAS THE NATIONAL FEAR ABOUT INTERRUPTION OF OUR OIL SUPPLIES AND THE PROPOSED PLAN FOR RATIONING GASOLINE AND WEEKEND CLOSINGS WHICH ACCOMPANIED THE SITUATION. THE SECOND, CLOSELY RELATED PROBLEM, HAS BEEN THE INCREASING PRICE OF MOTOR FUEL. THE THIRD AND PERHAPS OUR MOST IMPORTANT PROBLEM TODAY, HAS BEEN THE SQUEEZE BETWEEN RISING INTEREST RATES AND STATE USURY LAW CEILINGS PILED ONTO THE PROBLEMS OF THE GENERAL ECONOMY. THIS TRANSLATES INTO AN EXTREMELY DIFFICULT FINANCING PROBLEM FOR POTENTIAL RECREATION VEHICLE BUYERS ALL OVER THE COUNTRY.

HERE IS HOW WE'VE BEEN AFFECTED AT COACHMEN INDUSTRIES. IN 1978, A GOOD YEAR, COACHMEN PROVIDED EMPLOYMENT FOR 4,800 PEOPLE--CURRENTLY WE HAVE 2,800 EMPLOYEES; SALES VOLUME IN 1978 WAS 305 MILLION DOLLARS, WHILE LAST YEAR IT WAS 125 MILLION DOLLARS. OUR PRESENT SALES LEVEL OF 100 MILLION DOLLARS IN THE FIRST SIX MONTHS OF THIS YEAR--200 MILLION DOLLARS ANNUALIZED, INCLUDES GREATER MARKET SHARE PLUS DIVERSIFICATION EFFORTS ... BUT WE ARE STILL WELL BELOW 1978 LEVELS.

THESE FIGURES ARE MIRRORED BY MOST OTHER RECREATION

Vehicle Industry Association manufacturers and suppliers. Despite belt-tightening and aggressive marketing, most recreation vehicle manufacturers feel frustrated in attempting to market products in the face of state interest rate ceilings below money market rates, thus drastically reducing consumer availability financing. These frustrations and the earnings impact have led to the liquidation of a number of manufacturers in our industry.

But possibly even more hard hit than manufacturers, are the franchised dealers distributing our products ... thousands of small business firms across the country. As an example, Coachmen RV, our largest division, had 448 dealers at the end of 1978. At present, Coachmen RV has 290 dealers, a 35 percent decline. Even more alarming, during this timeframe, Coachmen RV added 160 new dealers, so there has been a 70 percent turnover of our dealers since 1978.

On a national basis, the Recreation Vehicle Dealers Association estimates that the failure rate among dealers has been 47 to 50 percent. This has meant the permanent loss of hundreds of small businesses and thousands of jobs.

RV buyers have a strong credit profile. They consistently have had low delinquency and good repayment records

AS RECORDED BY THE AMERICAN BANKERS ASSOCIATION.

THIS GOOD RECORD CONTINUES, DESPITE THE ECONOMIC RECESSION, AS EVIDENCED BY THE FOURTH QUARTER 1980 REPORTS OF BANK DELINQUENCY RATES FOR INSTALMENT LOANS. RV LOANS WERE SECOND WITH ONLY 2 PERCENT DELIQUENCY, COMPARED TO THE AVERAGE BANK LOAN OF 2.59 PERCENT.

WE'VE NEVER HAD COMPLAINTS OF RETAIL FINANCING AVAILABILITY UNTIL THE PAST EIGHTEEN MONTHS OF SKY-ROCKETING MONEY COSTS. NOW OUR DEALERS ALL ACROSS THE COUNTRY ARE EXPERIENCING REJECTION ... NOT FOR CREDIT REASONS ... BUT BECAUSE THE BANK IS NO LONGER MAKING THIS TYPE OF LOAN ... OR MORE SUBTLY, THE BANK WILL ONLY FINANCE THE RV FOR A CUSTOMER WITH AN EXISTING BANK RELATIONSHIP.

THE ACTUAL REASON FOR THE REJECTION OR TIGHTENING IS THAT AT THE CURRENT CEILING RATES, THE BANKS OR FINANCE COMPANIES CAN'T MAKE A PROFIT IN VIEW OF THEIR MONEY COSTS.

TO A SMALL BUSINESS, THE LOSS OF ONE OR TWO OR MORE SALES A WEEK, DUE TO THIS CREDIT NON-AVAILABILITY, IS THE DIFFERENCE BETWEEN PROFIT AND LOSS ... BETWEEN KEEPING AFLOAT OR GOING OUT OF BUSINESS.

THE CONSUMER, TOO, HAS BEEN AFFECTED.

THE ORIGIN OF THE USURY STATUTES WAS TO PROTECT THE CONSUMER. THE VOLATILE INTEREST RATES OF THE PAST SEVERAL YEARS MAY HAVE MADE THESE LAWS WORK AGAINST THE CONSUMER.

FIRST, THEY DICTATE THE CHOICE OF A PRODUCT OR SERVICE BY DENYING CREDIT TO OTHERWISE QUALIFIED CUSTOMERS, RATHER THAN LETTING THE CUSTOMER HIMSELF DECIDE WHETHER OR NOT THE RATES ARE TOO HIGH.

SECOND, IN MANY CASES, OUR DEALERS ARE REQUIRED TO PAY POINTS TO THE LENDER TO SUBSIDIZE THE STATE CONTROLLED RATE. THE DEALERS INCREASE THEIR PRICE STRUCTURE TO COVER THE COST OF THE POINTS, THUS RAISING PRICES ACROSS THE BOARD AND CAUSING THE CASH BUYER TO PAY MORE.

THIRD, WITH THE VARYING STATE RATES, INEQUITABLE COMPETITIVE SITUATIONS IN MARKETS CLOSE TO STATE BORDERS HAVE DEVELOPED ... A CUSTOMER TRAVELS ACROSS THE RIVER OR STATE LINE FOR A BETTER PRICE OR EASIER FINANCING SIMPLY BECAUSE OF STATE STATUTES INVOLVED. THIS SEEMS DISCRIMINATORY.

FOURTH, THE DECLINE OF DEALERSHIPS AS EVIDENCED BY

THE COACHMEN RV DIVISION EXAMPLE, MEANS INCONVENIENCE FOR WARRANTY SERVICE WITH THE CONSUMER HAVING TO TRAVEL MANY MORE MILES TO OBTAIN SERVICE THAN HE HAD ANTICIPATED.

AS I SAID, COACHMEN AND THE OTHER RV MANUFACTURERS HAVE FACED A REAL TRIPLE WHAMMY BEING SENSITIVE TO ENERGY AVAILABILITY, ENERGY COSTS, AND THE ECONOMY.

WE'RE WORKING THROUGH THE ENERGY SITUATION WITH BETTER AERODYNAMICS, LIGHTER COMPONENTS, INCREASED USE OF DIESELS, AND ADVANCED ENGINEERING FOR PRODUCTS COMPATIBLE WITH TODAY'S SMALLER CARS. OUR CUSTOMERS, TOO, ARE QUICKLY ADAPTING TO THE ENERGY SITUATION AND HAVE FOUND THE DELIGHTS OF OUTINGS CLOSER TO HOME.

BUT, THE SENSITIVITY TO THE NON-AVAILABILITY OF CREDIT CONTINUES, AND WE FEEL HELPLESS. AS BUSINESSMEN, WE CAN'T EFFECTIVELY CHANGE THE STATUTES OF EACH STATE WITH UNREALISTIC CONSUMER CREDIT CEILINGS.

SENATE BILL 1406, INTRODUCED BY SENATOR LUGAR, IS A FAIR AND EQUITABLE SOLUTION TO OUR PROBLEMS, AND WE WHOLEHEARTEDLY SUPPORT ITS PASSAGE. THE BILL FOLLOWS THE PRECEDENT OF REMOVING RATE CEILINGS AND EMPHASIZES A FREE MARKET PHILOSOPHY TO WHICH OUR MEMBERS HEARTILY SUBSCRIBE.

Perhaps the most compelling reason to pass this legislation is that it re-establishes freedom of choice for the American consumer and the American businessman.

Mr. Chairman, this concludes my formal comments and I will be happy to answer any questions from the Subcommittee.

American Recreation Coalition

Dedicated to the protection and enhancement of every citizen's right to pursue health and happiness through leisure-time activities.

April 26, 1983

The Honorable Jake Garn, Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510

Dear Senator Garn:

We ask that you incorporate this letter into the written record of the hearings held last week on S.730, the Credit Deregulation and Availability Act of 1983.

We support this legislation strongly. On March 19, 1981, the American Recreation Coalition's Board of Directors adopted the following policy position:

> Americans testify to the importance of recreation and leisure-time pursuits in their lives through their annual expenditure of more than $200,000,000,000 on these pursuits. Many of the expenditures are for recreational items or services of substantial cost for which consumers seek to pay on an extended basis. Such purchases include air vacation fares and cruises as well as pools, boats, RV's, snowmobiles and other consumer durable goods.
>
> Because of the essential role played by recreation in today's fast-paced world, the availability of financing for recreation and recreation-related expenses is of great importance. The American Recreation Coalition therefore supports public and private actions which facilitate the availability of consumer financing for recreation purposes.
>
> In recent years, the supply of consumer credit has been reduced and its cost increased by massive levels of federal government borrowing, made necessary by continuing large government budget deficits. The American Recreation Coalition believes that this borrowing -- in direct competition with American taxpayers' own credit needs -- must be restrained. To do so, the federal budget must be reduced and a balance must be achieved between federal revenues and expenditures.

Suite 700 • 1901 L Street, NW • Washington, D.C. 20036 • (202) 466-6870

The Honorable Jake Garn
April 26, 1983
Page Two

The availability of consumer credit has also been jeopardized by state usury laws which impose unrealistic limits on interest rates for consumer borrowing. While designed to protect consumers, these laws have proven to be too inflexible and have actually worked against consumers' interests. The American Recreation Coalition therefore supports laws at the federal and state levels which provide reasonable, flexible and competitive limits on consumer credit costs.

We urge prompt action on S.730.

Sincerely,

Derrick A. Crandall
President

DAC/mbk
cc: Beth Climo

American Recreation Coalition

Dedicated to the protection and enhancement of every citizen's right to pursue health and happiness through leisure-time activities.

The policy of the American Recreation Coalition on consumer credit supplies and controls is as follows:

Americans testify to the importance of recreation and leisure time pursuits in their lives through their annual expenditure of more than $200,000,000,000 on these pursuits. Many of the expenditures are for recreational items or services of substantial cost for which consumers seek to pay on an extended basis. Such purchases include air vacation fares and cruises as well as pools, boats, RV's, snowmobiles and other consumer durable goods.

Because of the essential role played by recreation in today's fast-paced world, the availability of financing for recreation and recreation-related expenses is of great importance. The American Recreation Coalition therefore supports public and private actions which facilitate the availability of consumer financing for recreation purposes.

In recent years, the supply of consumer credit has been reduced and its cost increased by massive levels of federal government borrowing, made necessary by continuing large government budget deficits. The American Recreation Coalition believes that this borrowing -- in direct competition with American taxpayers' own credit needs -- must be restrained. To do so, the federal budget must be reduced and a balance must be achieved between federal revenues and expenditures.

The availability of consumer credit has also been jeopardized by state usury laws which impose unrealistic limits on interest rates for consumer borrowing. While designed to protect consumers, these laws have proven to be too inflexible and have actually worked against consumers' interests. The American Recreation Coalition therefore supports laws at the federal and state levels which provide reasonable, flexible and competitive limits on consumer credit costs.

ADOPTED MARCH 19, 1981

AMERICAN RECREATION COALITION

American Camping Association
American Horse Council
American Hotel and Motel Association
American Land Development Association
American Motorcyclist Association
American Power Boat Association
American Recreational Equipment Association
American Ski Federation
American Water Ski Association
American Youth Hostels, Inc.

Boating Trades Association of Texas

Champion Fleet Owners Association
Colorado Campground Association
Connecticut Marine Trades Association

Experimental Aircraft Assn.

Family Motor Coach Association
Federation of Outdoor Recreationists
Foremost Insurance Company

Good Sam (camping) Club

Holland (Michigan) Motor Homes, Inc.

Institute for Career and Leisure Development
Intercoastal (golf cart) Manufacturing Company, Inc.
International Assn. of Amusement Parks & Attractions
International Kart Federation
International Snowmobile Council
International Snowmobile Industry Association
Intra-South (recreation) Publications, Inc.

Kampgrounds of America
Kampground Owners of America

Leisure Systems, Inc.

Marine Retailers Association of America
Michigan Boating Industries Association
Michigan Mobile Home and Recreational Vehicle Institute
Motorcycle Industry Council
Motorhome Travelers Association

National Association of Property Owners
National Campers and Hikers Association
National Campground Owners Association
National Federation of State High School Assns.
National Forest Recreation Association
National Hot Rod Association
National Industrial Recreation Association
National Marina Association
National Marine Manufacturers Association
National Motor Sports Committee
National Outdoor Coalition
National Retired Teachers Assn./American Assn. of Retired Persons
National Spa & Pool Institute
North American Family Campers Assn. Inc.
NRA Institute for Legislative Action

Outdoor Resorts of America, Inc.

Pony Baseball, Inc.

Recreation Vehicle Club Directors Association
Recreation Vehicle Dealers Association
Recreation Vehicle Industry Association
Roller Skating Rink Operators Association

Southern California Loners on Wheels
Southern California Marine Association
Special (handicapped) Recreation, Inc.
Specialty Equipment Market Association
Sporting Goods Business Magazine
Starcraft Owners Club

United Four Wheel Drive Association
United (recreational shows) Promotions, Inc.

Wally Byam Caravan Club International
Warehouse Distributors Assn. for Leisure and Mobile Products

Comments submitted by

SEARS, ROEBUCK AND CO.

Sears, Roebuck and Co. would like to take this opportunity to indicate its support for S. 730, introduced by Senator Garn and co-sponsored by Senator Proxmire and Senator Lugar. This proposed legislation, the Credit Deregulation and Availability Act of 1983, would extend the mortgage credit preemption established under the Depository Institution Deregulation and Monetary Control Act of 1980 and would act to preempt the remaining interest rate ceilings applying to consumer credit. We support the concept of giving credit grantors the ability to charge market rates of interest on consumer credit extensions.

Market rates of interest are key in the extension of credit. Experience has shown over the past few years that consumer interest rates are changeable and fluctuate in a somewhat similar fashion to the prime rate of interest. However, for creditors who are restricted during periods of high interest rates to an artificially imposed interest ceiling, two actions may be taken. First, creditors may restrict credit extensions. These actions tend to further exacerbate a weak economy by cutting off the desirable financial source which during normal times would act to reduce inventories and create additional demand for replacement goods. Second, creditors may take actions to shift operations from the state in which the lower rate exists to one providing a more favorable rate climate. While this certainly is an expensive proposition, many creditors have seen fit over the past few years to relocate.

We believe it is important for this Committee to recognize that retailers like Sears who offer their own credit plans are precluded because of recent court decisions from the second alternative mentioned above. Instead, retailers must assess finance charges at the rate of the customer's residence and not at the rate of the state in which the retailer's credit operations are located.

This, therefore, creates a need for an alternative solution for retailers. That solution is to raise the cash price of merchandise to offset the losses incurred on credit operations. This ultimately produces a cash price subsidy of the credit customer for the below market interest rate. In this event, all customers are forced to pay part of the cost of credit whether or not they have chosen to use the credit service.

The Credit Deregulation and Availability Act, S. 730, takes a balanced approach to the preemption of such artificial state rate ceilings. While preempting the rate itself, the bill would not preempt state consumer protection measures such as the methods of computing the balance on which finance charges are computed, recission rights, charges for resolving errors, provisions relating to rebates, provisions dealing with refinancings and repossessions, licensing provisions, disclosures, and so forth. Through this approach, the bill takes the optimum approach to resolve the goal of implementing market rates of interest. That is, while preempting the actual rate itself, the additional consumer disclosures and protections would not be affected. Sears supports this approach.

Sears appreciates the opportunity to express its views on S. 730.

Randolf H. Aires
Vice President,
Governmental Affairs

Christine A. Edwards
Staff Assistant,
Governmental Affairs

Charles T. Russell
President

April 8, 1983

The Honorable Jake Garn, Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am writing today in support of S. 730, the Credit Deregulation and Availability Act of 1983, introduced by yourself and Senators Proxmire and Lugar on March 8, 1983. I would like to take this opportunity to thank you on behalf of Visa U.S.A. for your continued interest in this vital legislation that will put an end to outdated state-imposed price controls in the form of usury laws.

Visa U.S.A. Inc. is a non-stock membership corporation, incorporated under the laws of the state of Delaware, which administers the Visa Card and Travelers Cheque Program within the United States. The membership of the corporation is comprised of approximately 13,000 commercial banks, savings banks, savings and loans associations, and credit unions which participate in the Visa program.

As of the end of 1982 the Visa "Blue, White and Gold" card was held by approximately 56.8 million individuals and accepted at 1,956,000 merchant outlets and 52,078 member offices throughout the country. For the year 1982, total dollar volume of the Visa system in the United States exceeded $40,934,456.

Visa fully supports the provisions of S. 730 and strongly urges its early enactment. We believe that this legislation is essential in light of increasingly dynamic interest rates that prevail in the national credit market, which must continue to respond to consumer needs and expectations. As in other segments of our economy, the imposition of artificial price controls is simply inconsistent with the efficient operation of a free market economy.

Given the increases in and dynamics of the costs that must be included in interest rates, and the increasingly important role that credit plays in today's society, it is essential that usury laws reflect market realities.

VISA U.S.A. Inc. *Post Office Box 8999, San Francisco, California 94128 (415) 570-3200*

The Congress has in the past recognized this concern on the national level in acting to provide temporary relief in the area of business and agricultural credit and permanently in the area of first mortgages. It has, however, left the regulation of consumer rate ceilings up to the individual state.

While a number of states have addressed the issue of interest rate ceilings, this piecemeal activity is not an adequate response for creditors operating in a national consumer credit market. The state-by-state approach has simply compounded the confusing patchwork of laws and regulations that now exist. Moreover, in many cases, recent changes affect only certain types of credit or creditors, are subject to "sunset" provisions, or merely replace one arbitrary ceiling with another.

Many studies have recognized that usury laws can inhibit growth in the economy and restrict needed credit, harming the consumer the law was meant to protect. The most recent review and analysis of usury laws was undertaken by an Interagency Task Force on Thrift Institutions, comprised of representatives from the federal financial regulatory agencies and the previous administration. In its June 30, 1980 report, the Task Force noted that, as a general proposition, the historic rationale for usury laws - to protect the consumer from unscrupulous lenders - simply was no longer valid.

The response that most appropriately addresses the legitimate interests of lenders and borrowers alike is to allow the free market - rather than artificial rate ceilings - to set interest rate levels, within a protective framework that assures fairness to the consumer. These multiple objectives can be achieved through existing consumer protections (such as Truth-in-Lending disclosures) while allowing creditors to receive a reasonable return on their investment - without being limited by artificial rate ceilings.

A competitive market for credit products and financial services will do more to serve the consumer than many of the laws and regulations now on the books. We are convinced that consumers are willing to pay a market price for credit but that they are increasingly concerned about its availability.

Deregulation of interest rate ceilings will spur competition among creditors, allowing the free market to operate. It will help eliminate the undesirable and, presumably, unintended subsidies involving, for example, less affluent credit purchasers subsidizing the more affluent "convenience users" who pay off their accounts, and the citizens of high rate states subsidizing the credit purchases of those in low rate states. Finally, by eliminating rationing of credit by means other than price, deregulation of interest rate ceilings will make credit available to all consumers, thus, in many cases, assuring the availability of credit to those who need it most.

S. 730 would also make an additional reform in the area of bank cards by authorizing annual, monthly or periodic fees and transaction fees. The prohibitions that exist on these fees in many states create an unfair burden on lower-income consumers and have contributed significantly to the unprofitability of card programs.

A Visa card provides to every cardholder two distinct services. First, it is a payment device which enables cardholders easily and conveniently to make payments for goods and services at more than 3,653,000 merchant locations throughout the world. Second, the credit card makes available a line of credit. In the event that payment of the balance is not made during the free period, the cardholder incurs a finance charge during the time required to pay off the credit balance in installments.

The two basic features of a Visa card are distinctly separate. Many cardholders use their cards primarily or exclusively for the convenience payment feature, routinely pay their card balances within the initial grace period, and rarely or never incur finance charges by electing to postpone payment and to use the line of credit also made available to them by the card.

As a result, 50 percent of Visa's annual dollar volume is paid within the free period and generates no finance charge. Those cardholders who do activate their line of credit and carry credit balances typically do not borrow up to their credit limit and then leave their cards dormant, but carry a fluctuating credit balance and continue also to use their cards for convenience payment purposes.

In many states, card issuers are required to give users a "free period" in which to pay all charges incurred without any charge for the convenience involved in this payments mechanism. As a result many consumers use their card simply as a convenient payment device - an alternative to cash or check. The card issuer incurs considerable expenses in processing purchases and payments and in extending funds during this period of "free use" but collects no finance or use charge.

Historically, consumers have been charged fees for the use of other payment devices and cash substitutes. Most banks traditionally have charged either monthly fees or transaction fees to users of checking accounts; holders of travel and entertainment cards which do not access lines of credit have been charged annual fees; users of travelers cheques have paid purchase fees for the cheques. However, the usury laws in many states have expressly worded or have been so construed as to prevent financial institutions which issue cards in those states from charging any fee for the benefit which cardholders receive from being able to use their cards as a convenience payment device.

The convenience transaction costs and expenses not covered by merchant discount income have to be paid for by periodic and transaction fees or underwritten by income from other sources. The burden of underwriting the convenience users of cards falls disproportionately on lower income cardholders who traditionally use the credit feature of their card and thus incur a finance charge. This burden is also borne by small financial institutions which are the most adversely affected by high interest rate trends. The most restrictive state usury laws are generally found where unit banking and small credit unions are most prevalent. Savings and loans, mutual savings banks and credit unions have only recently entered the card business and either are still in the process of absorbing heavy start-up costs or now will be deterred from ever offering this service to their customers.

It is the largest financial institutions which not only already have absorbed initial start-up costs, but can afford to relocate their card operations in states other than their home state in order to take advantage of favorable state usury laws. Because these cards have been held by the courts to be governed by the law of the state in which the card is issued, state usury laws restrict only card issuers located within the state by issuers located elsewhere. Thus, cards can be and are issued on a nationwide basis from a single location.

The largest issuers can afford to move their card operations because the additional revenue from periodic or transaction fees more than offsets the cost of the move. For example, of the 1,500 Visa members which issue Visa cards in the United States, 20 hold 50 percent of the 64,500,000 Visa accounts. For institutions with such large numbers of cardholders, it is economically feasible to relocate bank card operations in states which permit periodic or transaction fees. For smaller institutions, unit banks, and savings and loans with a small number of cardholders, a relocation of card operations would be uneconomical and in many instances would be prohibited by legal barriers. Thus, absent prompt action to establish a uniform policy enabling card issuers in all states to charge a reasonable fee for the convenience payment feature, the small local card issuers soon will be driven out of the business.

S. 730 would eliminate the advantage of relocating card operations into deregulated states and enable card issuers to insure that those who use their card only as a convenient method of payment would bear a fair share of expenses for their involvement in a payment, not credit, mechanism.

In conclusion, let me emphasize the benefits to be gained by the enactment of the provisions contained in S. 730. The long-term economic well-being of the bank card industry is dependent on these reforms. Studies on usury and bank card fees consistently indicate that the reforms proposed by S. 730 would benefit lenders, merchants and consumers alike.

Mr. Chairman, I commend your efforts in providing a forum where these important problems can be aired and appreciate this opportunity to comment.

Sincerely,

Charles T. Russell

CTR/m

MC
MasterCard
International Inc.

AMY TOPEL
Vice President and Counsel
(212) 974-5736

May 5, 1983

The Honorable Jake Garn
Chairman, Senate Committee
on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Re: S.730, the Credit Deregulation and Availability Act

Dear Senator Garn:

MasterCard International Incorporated ("MasterCard") welcomes the opportunity to submit this written statement in support of S.730 which you recently introduced to preempt state usury ceilings for extensions of consumer credit. S.730 would amend the Depository Institutions Deregulation and Monetary Control Act of 1980 to preempt state rate ceilings which attempt to limit the rates and types of charges that may be assessed in connection with consumer credit transactions. Covered charges would include transaction and access fees. In addition, the bill would permanently preempt state usury ceilings for agricultural and business credit. Individual states would have the ability to override the federal preemption and reimpose state ceilings for a three-year period after the bill's enactment date. Finally, state consumer protection laws would remain intact.

MasterCard is a membership corporation composed of more than 13,000 U.S. financial institutions which issue and honor the familiar MasterCard service marks in connection with a credit card program. MasterCard itself extends no credit and does not participate in the credit decisions of its members. Each member institution issuing the MasterCard credit card operates its own card program and makes independent credit decisions. The terms of agreement and policies regarding the establishment, maintenance and continuation of a consumer's credit card account are set and governed by the institution with which the consumer enters a credit relationship. This would include access fees, transaction fees and interest charges, the subject of this legislation. In setting policy, each institution naturally must now take into account the state-enacted usury ceilings and other unique laws adopted in the states in which they operate as well as marketplace factors in order to efficiently compete with other MasterCard card issuing institutions and other non-member institutions offering consumer financial services.

888 Seventh Avenue, New York, New York 10106 (212) 974-5700

MasterCard supports the fundamental premise of S.730 that interest rate ceilings should not be dictated by the government.

Historically, the rationale behind usury ceilings was that usury ceilings were needed as a form of consumer protection. That is, unless restrained in this manner, lenders could be compelled to charge consumers unconscionably high interest rates. In fact, the premise for enacting usury ceilings was more a moral or social one rather than an economic one. Myths that consumer lenders are not competitive, that consumers are ignorant about credit costs and that loansharking will result have improperly perpetuated the continued existence of a patchwork of state usury laws.

Many representatives from the consumer credit industry have come before your committee and others to explain why usury ceilings have become archaic and restrictive and why they are neither practical nor productive. Inflexible usury ceilings are an obvious disservice to the financial institution and, due to its inseparable relationship with the national economy, to the health of the national economy, as well. Financial institutions must, by dint of their charter, obligation to shareholders and account holders, and sheer good business judgement, lend money only at a reasonable rate of return which exceeds their expenses. Particularly in light of the experience of an erratic economy in recent years, rigid interest ceilings that are unresponsive to market pressures have placed regulated institutions in the noncompetitive and undesirable position of having to choose between making loans at a loss, reducing the credit available to borrowers (especially higher risk individuals), or, even worse, not making loans at all. None of these alternatives reflects a sensible policy of national economic thinking. When lenders are forced to cut back on lending, a negative ripple effect is felt on the purchasing power of consumers, in turn on the activity of consumer business and, in turn on the vitality of the consumer service economy as a whole. The report of the National Commission on Consumer Finance (1972) stated this best when it pointed to the consumer credit industry "...both as the lubricant which oils the wheels of our great industry machine and as the vehicle largely responsible for creating and maintaining in this country the highest standard of living in the world." (Page 1).

Moreover, Congress recently has taken great pains to deregulate the deposit function of the financial industry to assure its vigor and competitiveness. In phasing out the deposit account rate ceilings, Congress recognized the need for regulated institutions to be released from rigid and archaic laws which made them uncompetitive with unregulated entities, thereby threatening the continued ability of traditional institutions to service the consumer. Clearly, the lesson Congress learned about the deposit account experience should be applied to the asset side (lending function) of a bank's business as well. All of the arguments for a stronger, more competitive deposit service business apply with equal force to deregulation of the lending business. If the lending side of the industry is not likewise deregulated, the ability of the industry to offer market rates on deposits and to remain competitive on the deposit side will be severly jeopardized because the very income the industry relies on to pay for deposit interest would be restricted absolutely. Thus, without the deregulation of the asset side of an institution's business, recent Congressional action to promote competition and to help stabilize the financial industry and the economy would be thwarted.

Recent studies further substantiate the theory that usury ceilings have no viable presence in today's economy and instead of protecting the consumer, are now actually working against consumer interests. A February 1982 study published by the Chicago Federal Reserve Bank examined the economics of usury ceilings to identify the substance of arguments both for and against their establishment. The study cites empirical studies of U.S. credit markets that have found that (1) credit is less available when usury ceilings become binding and that, although binding usury ceilings may offer consumers lower interest rates, reduced credit availability is a likely result, (2) usury ceilings encourage lenders to adopt credit rationing practices unfavorable to borrowers, charges on credit card accounts or other changes in the non-interest terms of credit transactions, and (3) low-income, high risk borrowers are more likely to feel the pressure of reduced credit availability brought about by binding usury ceilings.

A recent study prepared at the University of Missouri again confirmed that usury ceilings result in a constriction of credit availability. The University reported that, in comparison to banks operating in unregulated states, banks functioning under the existing Missouri usury laws affecting consumer credit lend about 20% less to consumers.

Moreover, activity in the states that have lifted or relaxed their usury ceilings as a result of escalating market rates indicates, without doubt, that the fair market rate will be the rate lenders will assess, resulting in heightened rate competition and increased credit availability. Price gouging and loansharking, are, in no way, the result. Here are just a few examples. A recent survey conducted by the American Bankers Association of banks in states where some form of usury relief has been instituted indicated, in almost all cases, that the institutions (1) had been charging below market rates prior to relief, (2) six months after relief were charging higher rates, but none out of line with the prime lending rate; and (3) the current rate had been cut from the six month levels as market rates dropped in late 1982.

When Maryland raised its ceiling from 18% to 24% last July, the Maryland Commissioner of consumer credit surveyed the state's interest rate levels and found that interest rates generally were set well below the 24% level. In comments to the press, the Commissioner said that competition was working to keep rates well below the allowable levels. And in Ohio, where rates for installment loans and revolving credit were raised to 25% effective February 1982 (from approximately 18%), one bank reported that it had no plans to increase installment rates, given the descending prime rate. When a new law in Colorado in mid-1981 permitted the charging of up to 21% on credit cards, one large bank card system doing business with over one million cardholders in five states publicly announced that it would not raise its rates, basing the decision on the belief that interest rates would be decreasing in the coming months.

Once a market rate is established, not only does competition ensure that only appropriate rates will be charged, but credit becomes more available. Again, studies substantiate this statement. For example, results of a December 1982 study performed by the New York State Banking Department indicated that the 1980 New York law (which eliminated usury ceilings for consumer credit) actually had positive results. Although rates did rise a little because the previous rates had been unrealistically low, the availability of consumer credit increased, and New York banks began offering consumers a wide range of rates and fees, providing them with alternatives to choose from when shopping for credit. The New York legislature recently extended the deregulation law for four more years. According to press reports, the sponsor of the bill said that New York's experience with deregulated interest rates resulted in increased rate competition and greater credit availability for New Yorkers.

On another point, opponents of usury preemption contend that consumers would lose much needed protections. However, S.730 makes it absolutely clear that the federal preemption of state usury laws would not herald the end of consumer protections embodied in state law. As you know, each state has its own body of consumer protection laws. Among those are laws governing restrictions on disclosure requirements, prepayment penalties, methods of calculating interest, deceptive advertising and the fact that credit contracts be written in plain English. Many states, themselves, have adopted laws comparable to the Federal Truth-in-lending Act governing creditor responsibilities and consumer rights in credit card transactions.

In addition, on the federal level, we have a most comprehensive body of laws and regulations that govern the activities of creditors which have as their express purpose providing consumers with a maximum amount of protection. Among these laws, which govern disclosure and set forth consumer rights and creditor responsibilities, are the Truth-in-Lending Act, the Truth-in-Lending Simplification and Reform Act, the Fair Credit

Reporting Act, the Fair Credit Billing Act, the Equal Credit Opportunity Act, the Electronic Fund Transfer Act, the Community Reinvestment Act the Right to Financial Privacy Act, the Fair Debt Collection Practices Act, and the Bankruptcy Code of 1978. Also, financial institutions are subject to strict regulatory agency scrutiny and could not possibly "abuse" customers without fear of agency reprisal.

Opponents also contend that preemption is unnecessary since many states have relaxed their usury laws. While it is true that many states have raised or even eliminated their usury ceilings, the problem still exists. First of all, many of these laws are subject to a " sunset" provision. Without legislative action, such laws in Connecticut, Kansas and Mississippi, undoubtedly among others, will expire during 1983 or 1984 leaving the resolution of this issue in limbo, again yielding a destabilizing effect on consumer lending. States traditionally have clung to their "territorial rights" to regulate interest rates. Yet, the changes in the financial world described above and throughout the hearings dictate that the nature of lending today requires a national cohesive, deregulated approach.

It is hard to reconcile the fact that, given the national direction of monetary policy articulated by the federal government (for example, Federal Reserve pronouncements and actions), federal agency regulation, federal deposit insurance, federal laws on deposit rates, federal consumer protection laws, there exists a continued abandonment of federal guidance in the area of consumer lending rates. Clearly, given the upheavals in the financial marketplace it is more necessary today than ever before that Congress assume its proper role in establishing a national policy of consumer rate deregulation.

In summary, MasterCard applauds your understanding of the true effects of usury ceilings as evidenced by your sponsorship of S.730. It is essential that usury ceilings on consumer credit be permanently preempted and deregulated. We fully support S.730 and hope that a sound resolution of the usury problem will be reached at the conclusion of the legislative process.

Thank you for the opportunity to present our views.

Very truly yours,

Amy Topiel /sz

Amy Topiel

MEMBER
PROFESSIONALS NARI
NATIONAL ASSOCIATION
OF THE REMODELING INDUSTRY, INC.

April 28, 1983

Senator Jake Garn
Chairman
Senate Committee on Banking, Housing and Urban Affairs
SD 543
Washington, D.C. 20510

Attn.: Beth Climo

Dear Senator Garn:

Thank you for allowing the National Association of the Remodeling Industry the opportunity to express its view regarding S. 730.

As you are aware, one of our predecessor organizations, the National Home Improvement Council, submitted a statement dated July 15, 1981 in support of similar legislation. Unfortunately, from our viewpoint, that legislation was not adopted. Since you are currently conducting hearings on S. 730, we are pleased to take this opportunity to add our support to the bill. NARI urges passage of this legislation for the reasons that NHIC backed similar legislation two years ago.

Our principal concern in the extension of federal preemption of state usury laws relating to consumer loans would be home improvement loans. While it is true that of late there have been favorable trends in both money supply and interest rates, no one would dare presume that this situation will never again change.

With much of the nation's housing stock aging, and with housing starts severely depressed in recent years, the importance of home improvements and rehabilitation is obvious. However, at a time when improvements for structural integrity, energy efficiency and other vital purposes was most needed, financing was most difficult to obtain.

One factor contributing to that difficulty is addressed by S. 730--state usury limits on consumer loans. At a time when the prime rate in lending institutions approached, and even exceeded, 20 per cent, in almost half of the 50 states legislation was in effect which made improvement loans almost impossible to obtain. In at least 22 states, usury ceilings all but precluded consumer loans. At that time, thrift institutions had to pay upwards of 15% interest to attract deposits, but were prohibited from charging interest rates on loans which would be realistic in such an economy.

The attrition rate in the remodeling/home improvement industry is astronomical. In this $47 billion industry, 94 of every 100 contractors who enter the industry fail. The inability of the consumers to obtain financing during cyclical periods contributes to this terrible rate. And, not only are small businessmen hurt, the manufacturers who make the products contractors buy and use also find their markets drying up.

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While $47 billion is a huge sum, the rate of growth in the 1980's for the home improvement industry has consistently fallen below projections. This at a time when housing starts were far below normal and improvements consequently should have increased greatly. The lack of available financing has been identified as a major factor for the industry's disappointing performance during that period.

The issue transcends even this most important industry. While housing starts are expected to slowly recover, so long as mortgage money and rates are reasonable, much of the nation is in a situation of housing inventory far below demand. Not only are families desiring first homes frozen out of the market, but families who have outgrown their present homes are denied the opportunity not only to purchase another but also to adapt their present dwelling to their needs. Additionally, 700,000 units are lost each year to demolition, old age, fire and other causes. Finally, it must be recognized that significant portions of the existing housing stock are substandard. Clearly, the continuation of this situation is not in the national interest.

For all these reasons, the National Association of the Remodeling Industry supports S. 730. While we do not view the bill as some sort of panacea for all the ills of the nation's housing and remodeling industries, it is our conviction that adoption will contribute to a more stable atmosphere.

Thank you again for this opportunity to express our views.

Sincerely,

Miles McBurney
Director of Communication/
Member Services